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No. 237

In the Supreme Court of the United States

October Term, 1948

WISCONSIN ELECTRIC POWER COMPANY,
Petitioner,

vs.

THE UNITED STATES OF AMERICA.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit, and Brief in Support Thereof.

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Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner prays that a writ of certiorari issue to review the judgment entered May 26, 1948, in the United States Circuit Court of Appeals for the Seventh Circuit which affirmed a judgment entered by the United States

District Court for the Eastern District of Wisconsin adverse to the petitioner.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals for the Seventh Circuit is reported in 168 Fed. (2d) 285 Advance Sheets. Therein is adopted as and for the opinion of that Court, the opinion of the District Court, reported in 69 Fed. Supp. 743.

JURISDICTION.

The judgment of the Circuit Court of Appeals for the Seventh Circuit was entered May 26, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, c. 229 (43 Stat. 938) (28 U.S.C.A. 347).

The cases believed to sustain said jurisdiction are as follows:

United States of America, Petitioner, v. Ogilvie Hardware Company, Inc., 330 U. S. 709 at 711.
(Conflict of decisions on tax refund.)

Edgar S. Albrecht and Geraldine Albrecht, his wife, et al, Petitioners, v. United States of America, 329 U. S. 599 at 620.
(Apparent conflict of decisions and question of widespread importance.)

Beulah B. Crane, Petitioner, v. Commissioner of Internal Revenue, Respondent, 331 U. S. 1 at 5.
(Importance of questions raised on proper construction of Internal Revenue Code.)

Federal Communications Commission, Petitioner, v. Woko, Inc., 329 U. S. 223 at 226.

(Importance of issue to administration of a statute.)

International Railway Company, Appt. and Petitioner, v. George G. Davidson Jr., Individually and as Collector of the Port of Buffalo, et al, 257 U. S. 506 at 516.

(Importance of validity of a Treasury ruling.)

SUMMARY STATEMENT.

In this suit petitioner sought the recovery of $6,806.84 on the ground that such amount was unlawfully collected from it as federal electricity taxes under Section 3411 (a) of the Internal Revenue Code. The period of the transactions subjected to such tax imposition included April 1, 1940, to July 1, 1943, during which time the petitioner sold electrical energy to various dairies engaged in the pasteurization of milk and functions normally incident to such pasteurization and the preparation of milk for sale. It has been and continues to be the position of the petitioner that such sales of electrical energy are not taxable transactions.

The issues presented to the Trial Court by the pleadings, the evidence and an agreed Stipulation of Facts (R. 9-48) involved the validity of the action of the Commissioner of Internal Revenue in rejecting and disallowing petitioner's claim for refund premised upon the sale of electrical energy to dairies being for other than commercial consumption, and for such reason not a taxable transaction under Section 3414 of the Internal Revenue Code.

The opinion of the Trial Court held that sales of electrical energy to dairies constituted a taxable transaction (R. 140-148). Such opinion expressly rejected the contrary view expressed in *United States v. Public Service Co. of Colorado*, (C.C.A. 10th), 143 Fed. (2d) 79, (R. 146). Findings

of Fact and Conclusions of Law, together with a judgment dated February 14, 1947, consistent with the view of the District Court were duly entered (R. 147-153; 154).

Upon an appeal taken by the petitioner from such adverse judgment to the United States Circuit Court of Appeals for the Seventh Circuit, judgment of affirmance was entered on May 26, 1948 (R. 168). The opinion there filed comments with approval on the reasoning adopted by the District Court and concludes "hence we are content to adopt his opinion as that of this court." (R. 168.)

STATUTES INVOLVED.

The pertinent portions of Section 3411 of the Internal Revenue Code, Treasury Regulations 42 and 46, promulgated thereunder, together with certain information of historical significance are printed in the Appendix, *infra*, pp. 22 to 26.

QUESTIONS PRESENTED.

1. Whether the determination of the Circuit Court of Appeals for the Seventh Circuit was correct in apparently departing from the principle announced by the Circuit Court of Appeals for the Tenth Circuit in the case of *United States v. Public Service Co. of Colorado*, 143 Fed. (2d) 79, by holding that the petitioner, a public utility, selling electrical energy through non-differentiating meters to its dairy customers for use by them in the pasteurization of milk and in functions normally incident to such pasteurization and in the preparation of milk for sale, was, by reason of a commercial aspect in the dairy business, selling such energy for commercial consumption so as to render such sales taxable under Section 3411 of the Internal Revenue Code, under

which section only energy sold for domestic or commercial consumption is taxable?

2. Whether the decision of the Circuit Court of Appeals for the Seventh Circuit conflicts not only with the decision of the Circuit Court of Appeals for the Tenth Circuit in the case of *United States v. Public Service Co. of Colorado*, 143 Fed. (2d) 79, but presents also an apparent conflict with the language contained in or the application of Treasury Regulations 46, Section 316.190?

REASONS FOR GRANTING THE WRIT.

The decision of the Circuit Court of Appeals for the Seventh Circuit in its construction of Section 3411 of the Internal Revenue Code asserted that it would adopt the opinion of the Honorable F. Ryan Duffy, Judge of the District Court of the United States for the Eastern District of Wisconsin, on the question as to whether or not the consumption of electrical energy by dairies was a "commercial consumption" as contrasted from other than commercial consumption such as a processing or an "industrial consumption." Such opinion by Judge Duffy in commenting upon the case of *United States v. Public Service Co. of Colorado*, 143 Fed. (2d) 79, stated, in part, as follows:

> "* * * I do think that case was wrongly decided and that judgment herein must go for the defendant * * *" (R. 146.)

Such situation presents a case of apparent conflict. Inasmuch as the proper construction of Section 3411 of the Internal Revenue Code would seem to affect the collection of tax revenue in the relation of all public utility taxpayers to their dairy customers in the United States, the matter appears to be of widespread importance and would seem to justify intervention by this Court on an important point of

statutory construction. Such issue relating to the administration of the Internal Revenue Code involves an important question of federal law which has not been, but which should be, decided by this Court.

2. The decision of the Circuit Court of Appeals for the Seventh Circuit is largely, if not entirely, predicated upon the existence in the dairy industry of a commercial aspect coupled with the reasoning that all uses of electrical energy were in fulfillment of such aspect, regardless of the nature of such specific uses. The applicable Treasury Regulations, however, direct inquiry as to whether or not energy is consumed in "commercial phases of industrial or other business" and the "predominant character of the business carried on at such location" (T. R. 46, Section 316.190), and accordingly, the decision of the Seventh Circuit may conflict with the Regulations or give rise to extreme difficulties in their application.

Wherefore, it is respectfully submitted that this petition should be granted.

Dated, August 19th, 1948.

VAN B. WAKE,
Attorney for Petitioner.

BRIEF IN SUPPORT OF PETITION.

OPINIONS.

One opinion was delivered by the District Court. It was written by District Judge, F. Ryan Duffy and filed December 31, 1946. It appears on pages 140 to 146 of the Record and is reported in 69 Fed. Supp. 743. The opinion of the Circuit Court of Appeals for the Seventh Circuit (Circuit Judges Otto Kerner and Sherman Minton and District Judge Walter C. Lindley, Judge Kerner writing) was filed May 26, 1948, and appears on pages 166 to 168 of the Record. It is reported in 168 Fed. (2d) 285, Advance Sheets.

JURISDICTION.

The judgment of the Circuit Court of Appeals for the Seventh Circuit was entered May 26, 1948. The jurisdiction of this Court is sought to be invoked under Section 240 (a) of the Judicial Code.

Cases wherein jurisdiction was sustained for the purposes of review by certiorari in internal revenue matters or of matters of widespread importance are:

United States of America, Petitioner, v. Ogilvie Hardware Company, Inc., 330 U. S. 709 at 711. (Conflict of decisions on tax refund.)

Edgar S. Albrecht and Geraldine Albrecht, his wife, et al, Petitioners, v. United States of America, 329 U. S. 599 at 620. (Apparent conflict of decisions and question of widespread importance.)

Beulah B. Crane, Petitioner, v. Commissioner of Internal Revenue, Respondent, 331 U. S. 1 at 5. (Importance of questions raised on proper construction of Internal Revenue Code.)

Federal Communications Commission, Petitioner, v. Woko, Inc., 329 U. S. 223 at 226.
(Importance of issue to administration of a statute.)

International Railway Company, Appt. and Petitioner, v. George G. Davidson Jr., Individually and as Collector of the Port of Buffalo, et al, 257 U. S. 506 at 516.
(Importance of validity of a Treasury ruling.)

SUMMARY STATEMENT.

This case was tried upon a stipulation of facts, coupled with evidence introduced on behalf of each party. Findings of Fact and Conclusions of Law were filed by the District Court of the United States for the Eastern District of Wisconsin, in conformity with the opinion of that court, on January 23, 1947 (R. 147). The petitioner is a Wisconsin corporation engaged in the operation of a public utility for the sale of electrical energy in and around Milwaukee, Wisconsin, and in such undertaking is generally subject to Section 3411 of the Internal Revenue Code, which imposes a tax on such energy sold for *domestic or commercial* consumption.

The petitioner, having in its tax payments under Section 3411 included an amount equivalent to the incidence of the tax on its sales to certain dairy customers during the period of April 1, 1940, through July 31, 1943, on May 25, 1944, filed a refund claim with the Collector of Internal Revenue at Milwaukee, Wisconsin, demanding refund of such part of the taxes paid as represented the portion attributable to such sales to dairies. On October 16, 1944, the Commissioner of Internal Revenue disallowed the claim for refund (R. 10). On November 1, 1944, the petitioner filed suit in the District Court of the United States for the Eastern District of Wis-

consin for recovery of the amount of tax specified in its claim for refund in the amount of $6,806.84 with interest from February 1, 1942, the average date of tax payments.

During the period under inquiry, the petitioner had furnished the electrical energy to its dairy customers and received payments therefor under rates prescribed by the Public Service Commission of Wisconsin and in such payments had not received the amount equivalent to a tax component on such energy sales (R. 13). The petitioner in its claim for refund and in the instant action contended for an exemption from the electrical energy tax in respect of electrical energy sales to dairies upon the theory that the consumption of such energy was other than commercial consumption, rather than commercial, based upon the character of the process of pasteurization (R. 3). As is reflected in the Findings of Fact, the evidence of the petitioner was primarily addressed to the nature and importance of the art of pasteurization as its exists in the dairy industry, while that on behalf of the Government was directed to support its basic contention that a dairy enterprise is inherently commercial in nature, rendering legally immaterial the precise uses of electrical energy therein (R. 148-152).

The District Court entered judgment adverse to the petitioner on February 14, 1947. Judgment of affirmance was entered in the Circuit Court of Appeals for the Seventh Circuit on May 26, 1948, which judgment petitioner now seeks to review.

SPECIFICATION OF ERRORS TO BE URGED.

The Court below erred:

1. In holding that the status of electrical energy sales by petitioner to certain of its dairy customers, *as being either for commercial or non-commercial consumption*, was ascertained, not by reference to the particular operations

in which the energy was used by the customers to process the product sold by them, but through the determination of the existence of a commercial phase in the pursuits of such customers.

2. In adoption, at variance with the theory of Treasury Regulations, a basis of classification for determining taxability dependent upon the principle that the business of the consumer, judged as an entirety, rather than the nature of electrical energy consumption at each separately metered location should govern.

SUMMARY OF ARGUMENT.

I.

The Decision of the Circuit Court of Appeals Decided a Question of Federal Law in a Manner so as to be in Probable Conflict with a Decision from the Tenth Circuit on a Similar Case.

In the case of *United States v. Public Service Co. of Colorado*, 143 Fed. (2d) 79, it was held that the pasteurization of milk in dairies was not a mere incident in a commercial undertaking, but was an industrial phase of such enterprise and the use of electricity therefor was not a commercial use. (Page 12)

The existence of a commercial phase in such an undertaking did not render all activities therein commercial in nature. (Page 12)

In the instant case the Circuit Court of Appeals reached a contrary conclusion. (Page 15)

Exertion of jurisdiction by this Court is justifiable. (Page 15)

II.

The Decision of the Circuit Court of Appeals Appears to have Departed from the Theory and Language of Applicable Treasury Regulations in which the Nature of Electrical Consumption at each Separately Metered Location is Emphasized.

The present decision adopted as the applicable classification for taxability the rule of "the predominant character of the enterprise carried on by the consumer." (Page 16)

Application Treasury Regulations place emphasis upon the predominant function carried on at the location where the energy is used. (Page 16)

Results not contemplated by the Regulations might follow if the language of the present decision were the governing rule. (Page 17)

In the present case the commercial activity, represented by sales, took place away from the premises where the energy was consumed. (Page 18)

The Regulations have continued under repeated re-enactments of the statute and are entitled to judicial recognition. (Page 19)

ARGUMENT.

I.

The Decision of the Circuit Court of Appeals Decided a Question of Federal Law in a Manner so as to be in Probable Conflict with a Decision from the Tenth Circuit on a Similar Case.

In the case of *United States v. Public Service Co. of Colorado*, 143 Fed. (2d) 79, the Circuit Court of Appeals for the Tenth Circuit had before it the contention of the Government that the consumption of electrical energy by dairies for pasteurization of milk was in fact a commercial use, since it was there claimed that pasteurization was but a minor function of the dairy enterprise, and hence was but an incident in a revenue producing business. Such contention was answered by that Court with the following language:

> "* * * The government now argues that none of the dairies 'derived its receipts directly from pasteurization of milk or carried pasteurization on as a business,' but that pasteurization was merely an incident to the main enterprise of selling and distributing milk. With equal force, it might be contended that manufacturing is but an incident to the main business of the manufacturer, to-wit, the selling of the manufactured article. In the final analysis all business is commercial. If the ultimate aim of industry is the test to be used in determining whether or not electrical energy used in the industry is taxable, all such energy would be taxable, and the admitted intent of Congress would be defeated." (Page 81)
>
> * * *
>
> "* * * Aside from the regulation, however, the electrical energy is exempt. It was not sold for commercial consumption within the meaning of the Act. All industry in a sense is commercial, but admittedly industrial consumption is not included. A manufacturer intends ultimately to sell his goods—his income is derived from the sale of his product. True,

the twenty dairies were buying and selling milk, but they were doing more—they were processing—pasteurizing raw milk in preparation for the market. Although the product sold was milk, it was not raw milk. The electrical energy was not used in a commercial phase of the dairying enterprise, but in the processing or industrial phase of the enterprise." (Page 82)

"In view of the admitted legislative intent, the regulation defining industrial consumption, as distinguished from commercial consumption, was appropriate. The term 'commercial' may have a broad or a narrow meaning. In its broad meaning it encompasses industrial enterprises or all business. In the narrow meaning of the term 'commercial' is included only those enterprises engaged in the buying and selling of goods. The legislative history of the Act would indicate that Congress was using the word 'commercial' in the restricted rather than the broad sense." (Page 80)

The facts of such case before the Court, as set forth on page 80 of the opinion, were as follows:

"The stipulation discloses that the twenty dairies are each engaged principally in the business of pasteurizing, bottling and selling milk. A preponderance of the gross revenue of each is derived from the sale of pasteurized milk and cream. The supply of milk is bought from farmers and is brought to the dairy from milk stations in tank trucks and from country milk routes in cars. The raw milk is then pasteurized, bottled and sold, either at retail or wholesale. Each of the dairies also manufactures and sells ice cream and butter; but the predominant use of electrical energy is in the pasteurization of milk or some necessary operation in connection therewith, that is, cooling or refrigeration, pumping water, washing of bottles and cans."

The opinion also quoted from the findings and conclusions of the Trial Court as follows:

"The trial court found as a fact, 'In all of the twenty dairies whose use of electrical energy is in-

volved in this action, the processing and sale of pasteurized milk and cream, to render it fit for human consumption, represents the predominant character of the business * * *' and reached the following conclusion of law, 'The electrical energy involved in this action as utilized and consumed by the twenty dairies is not electrical energy sold for domestic or commercial consumption within the act, supra, but constitutes a 'process' within Article 40 of Regulations 42 adopted by the Commissioner of Internal Revenue * * *'." (Page 80)

The Circuit Court of Appeals for the Seventh Circuit in the instant case described the determination of the Trial Court as being,

> "* * * that the incidence of the tax did not depend upon the particular operation in which the energy was used, but upon the business of which it formed a part, and that since the predominant business of the dairies was that of fluid milk dealers and distributors, the electricity sold to the dairies by plaintiff was sold for commercial consumption." (R. 167)

Approval of such determination and the adoption of the opinion of the District Court by the Circuit Court of Appeals appears from the concluding portion of Circuit Judge Kerner's opinion, which reads:

> "We have studied the *Public Service Co.* case, *supra*, and *Michigan Allied Dairy Assn. v. Auditor General*, 302 Mich. 643, 5 N.W. (2d) 516, as well as the other cases cited by plaintiff, and considered plaintiff's argument, but we have not been persuaded that the court erred in holding that the proper test to be applied in determining whether the electricity used by a particular consumer falls within the term 'commercial consumption' is whether the predominant character of the enterprise carried on by such consumer is commercial. We agree with Judge Duffy that the wording and legislative history of the Act make it clear that the predominant character of the business carried on by a consumer of electrical energy is what determines whether the electricity sold has

> been sold for 'commercial consumption'; hence we are content to adopt his opinion as that of this court." (R. 167)

The opinion of the District Court thus adopted clearly announced that it constituted a departure from the rule of the Tenth Circuit. Judge Duffy covered such point with the express language:

> "However, it seems to me that that Court's decision is contrary to the holding herein on the basis of the following statement in the opinion (p. 82):
>
> > 'The electrical energy was not used in the commercial phase of the dairying enterprise but in the processing or industrial phase of the enterprise.'
>
> With due deference to the court announcing the decision in *United States v. Public Service Co. of Colorado, supra*, I do think that case was wrongly decided and that judgment herein must go for the defendant, dismissing the complaint to the extent it seeks return of taxes paid on sales of energy to twenty-seven milk dairies." (R. 146)

The decisions of the Circuit Court of Appeals and the District Court in the instant case present a determination in distinct conflict with that announced for the Tenth Circuit in the case of *United States v. Public Service Co. of Colorado*, 143 Fed. (2d) 79. The petitioner asserts the principle of that case to be the sound rule, based upon the legislative history of the enactment in question. A justifiable basis for assumption of jurisdiction by this Court exists not only to reconcile a conflict of decisions, but also to give final determination to a matter of widespread importance on a question of statutory construction dealing with a novel point in internal revenue collection and affecting the relations between the Bureau of Internal Revenue and all taxpayers who sell electrical energy to dairy enterprises.

II.

The Decision of the Circuit Court of Appeals Appears to have Departed from the Theory and Language of Applicable Treasury Regulations in which the Nature of Electrical Consumption at each Separately Metered Location is Emphasized.

In adopting the finding of fact and opinion of the District Court, the Circuit Court of Appeals in the instant case determined the issue of taxability by restating the principle of law involved as follows:

> "* * * the incidence of the tax did not depend upon the particular operation in which the energy was used, but upon the business of which it formed a part, and that since the predominant business of the dairies was that of fluid milk dealers and distributors, the electricity sold to the dairies by plaintiff was sold for commercial consumption." (R. 167)

The Court stressed as the applicable criterion "the predominant character of the enterprise carried on by such consumer" (R. 167). It would seem that such quoted language imports a classification for taxability which is at variance with applicable Treasury Regulations, in which emphasis is placed upon the function conducted at the location where the energy is used.

Treasury Regulations 46, Section 316.190 (App. 25) as an introductory statement singles out for taxability all energy sold for domestic or commercial consumption except as otherwise provided, and thereafter details certain categories of use which are admittedly neither domestic nor commercial. Thereafter, the Regulation recognizes that certain commercial or domestic "phases" may exist at a given location as a part of an enterprise which would not generally be subject to tax, stating:

"* * * However, electrical energy is subject to tax if sold for consumption in commercial phases of industrial or other business, such as in office buildings, sales and display rooms, retail stores, etc., or in domestic phases, such as in dormitories or living quarters maintained by educational institutions, churches, charitable institutions, or others."

Finally, the Regulation directs inquiry, independently of the over-all undertaking of the consumer, concerning the predominant function carried on at the location of consumption, declaring:

"Where electrical energy is sold to a consumer for two or more purposes, through separate meters, the specific use for which the energy is sold through each meter, i.e., whether for domestic or commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy consumed at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of this tax."

Results not contemplated by the Regulations could reasonably be expected to follow if the language of the Circuit Court of Appeals' decision represents the governing rule. From such language the classification of taxability would be dependent upon the consumer's business as an entirety rather than upon the nature of the consumption at each separately metered location. Thus, in the case of an enterprise clearly industrial in character, such as that of United States Steel, energy consumed would be presumably nontaxable even though supplied at a location where commercial activities were predominant. On the other hand, energy supplied to a textile mill, owned by a chain store organization which sold at various retail stores the entire output of the mill, would become taxable as commercially consumed energy utilized by a predominantly commercial undertaking.

Both of such results, while in accordance with the language of the court decision, would seem to be contrary to the concepts of the Regulation.

In the instant case, despite the determination of the courts below that the dairies were commercial institutions, the commercial aspects of the business were primarily carried on away from the premises where the energy was consumed. Thus, Finding of Fact number eight states:

> "8. For all the operations described in the preceding paragraph hereof, each dairy maintains a fleet of trucks and other vehicles and drivers. In most cases, the drivers have standing orders to deliver specified amounts of milk each day. In other cases, the amounts are specified at the time of delivery. The drivers also collect for the milk delivered, obtaining payment from some customers in advance for the milk, from some at the time of delivery, and from some by the week." (R. 149)

A portion of Finding of Fact number seven, which further demonstrates that the commercial activities of the dairies are not carried on at the plants, states:

> "* * * Except as retail or wholesale depots are maintained, or as deliveries are made to stores, each of the dairies delivers its milk and other dairy products directly to consumers by use of the horse-drawn vehicles and trucks." (R. 149)

The opinion of the District Court also recognizes that the commercial activities were pursued by the dairies away from their plant locations (R. 141). The exhibits attached to the Stipulation of Facts (R. 19-48) show in detail that the plants are not the locations of commercial sales. In only one instance are there any direct sales on the premises where in the case of a small dairy the stipulation states:

> "A retail store maintained in the front of the plant building sells about 25 per cent of the ice cream

and a very small per cent of the milk pasteurized and bottled." (Exhibit 1, R. 33)

On the other hand, in the instance of at least one large dairy, the stipulation recites, "This company also has three distribution branches at other locations in the city, for which no exemption from tax is claimed, and a part of each day's output of this plant is delivered to these three distribution branches after being bottled or packaged" (Exhibit E, R. 121).

Under the language of the decision of the Seventh Circuit, though not within the ambit of the applicable Regulations, the Act could easily be carried into a factual situation never intended by Congress to be covered because of the assumed commercial phase of the functions of a dairy. Thus, should one of the Wisconsin dairies in question own and maintain its own herd of cattle at a location naturally removed from the dairy plant, own either directly or indirectly an electrical distribution system from farm to pasteurization plant, own a bottle manufacturing plant separately located, and own a geographically separated ice manufacturing plant, all of which facilities were entirely used by the dairy in the furtherance of its business of supplying pasteurized milk to others, and should each be separately metered, the language of the decision would be sufficiently extensive to render each of the separate pursuits a taxable function. Certainly, the Regulations do not purport to extend the law to such limits.

The Treasury Regulations have existed in substantially the same form since the enactment of the present law in 1933. Even under the Revenue Act of 1932, when the tax was one imposed directly upon the consumer, they were cast in substantially the same form except for their direction upon the consumer rather than upon the vendor of electrical energy. Such regulations continuing under re-enactment of

a specific act are not subject to judicial disregard except for reasons of substance. In the case of *Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, v. Robert C. Winmill*, 305 U. S. 79 at page 83, it was said:

> "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially re-enacted statutes, are deemed to have received congressional approval and have the effect of law.
>
> "There has been tacit, if not express judicial approval for the administrative treatment of comissions as an element of the cost of securities."

See also *Thomas W. White et al, former Collector of Internal Revenue for the District of Massachusetts, Petitioner, v. Winchester Country Club*, 315 U. S. 32 at 41.

The only substantial variation attempted by the Regulations has been the deletion of the word "process" in describing or illustrating those activities which were clearly industrial in character. This change occurred on November 28, 1941, and was held by the Tenth Circuit to be ineffective to place pasteurization (admittedly a process) into a non-industrial category. That court in the case of *United States v. Public Service Co. of Colorado*, 143 Fed. (2d) 79, on this point stated at page 81:

> "The regulation does not conflict with the express terms of the statute unless it may be said that processing is a commercial transaction as the term is used in the Act. The Treasury Department for nine years did not think so. The regulation, being a contemporary construction of the Act, is entitled to respectful consideration and is not to be overruled except for weighty reasons."

The language of the decision of the Seventh Circuit, upon which review is now sought, appears to extend the field of

taxability to limits not justified by congressional intention as reflected through legislative history.

CONCLUSION.

A rather clear conflict seems manifest between the present decision of the Circuit Court of Appeals for the Seventh Circuit and that which represents the determination of the Tenth Circuit. A matter of widespread importance has been presented by comparison of such decisions, independently of the issue of technical conflict. The exercise of jurisdiction by this Court would be further justified by the apparent divergence between the immediate decision and the applicable Treasury Regulations both in language and theory.

Respectfully submitted,

VAN B. WAKE,
Attorney for Petitioner,
773 North Broadway,
Milwaukee 2, Wisconsin.

APPENDIX.

Internal Revenue Code:

> SEC. 3411. TAX ON ELECTRICAL ENERGY FOR DOMESTIC OR COMMERCIAL CONSUMPTION.
>
> (a) There shall be imposed upon electrical energy sold for domestic or commercial consumption and not for resale a tax equivalent to 3 per centum of the price for which so sold, to be paid by the vendor under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe. The sale of electrical energy to an owner or lessee of a building, who purchases such electrical energy for resale to the tenants therein, shall for the purposes of this section be considered as a sale for consumption and not for resale, but the resale to the tenant shall not be considered a sale for consumption.
>
> * * *

(26 U.S.C. 1940 ed., Sec. 3411.)

Section 3411 (a) was amended by the Revenue Act of 1941, c. 412, 55 Stat. 687, Sec. 521 (a) (19), to change the three per cent tax to three and one-third per cent but left the section otherwise the same.

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 616. TAX ON ELECTRICAL ENERGY.
>
> (a) There is hereby imposed a tax equivalent to 3 per centum of the amount paid on or after the fifteenth day after the date of the enactment of this Act, for electrical energy for domestic or commercial consumption furnished after such date and before July 1, 1934, to be paid by the person paying for such electrical energy and to be collected by the vendor.
>
> * * *

Act of June 16, 1933, c. 96, 48 Stat. 254:

Sec. 6. (a) Effective September 1, 1933, section 616 of the Revenue Act of 1932 is amended to read as follows:

SEC. 616. TAX ON ELECTRICAL ENERGY FOR DOMESTIC OR COMMERCIAL CONSUMPTION

(a) There is hereby imposed upon electrical energy sold for domestic or commercial consumption and not for resale a tax equivalent to 3 per centum of the price for which so sold, to be paid by the vendor under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe. The sale of electrical energy to an owner or lessee of a building, who purchases such electrical energy for resale to the tenants therein, shall for the purposes of this section be considered as a sale for consumption and not for resale, but the resale to the tenant shall not be considered a sale for consumption.

* * *

Treasury Regulations 42, promulgated under the Revenue Act of 1932:

Art. 40. *Scope of tax.* The tax applies to the amount paid for all electrical energy furnished for domestic or commercial consumption, either by a privately or publicly owned operating electrical power company.

"Electrical energy for domestic or commercial consumption" includes all electrical energy furnished the consumer except electrical energy furnished for industrial consumption. Electrical energy for industrial consumption includes that used generally for industrial purposes, that is, in manufacturing, processing, mining, refining, irrigation, shipbuilding, building construction, etc., and by public utilities, waterworks, telephone, telegraph, and radio companies, railroads, and other common carriers.

The tax attaches to all amounts paid for electrical energy for domestic or commercial consumption

irrespective of whether any of the energy paid for is actually used. In other words, the tax is due on all payments for electrical energy whether in the form of a minimum charge, a flat charge, or otherwise.

* * * *

T. D. 4393, XII-2 Cum. Bull. 322 (1933):

* * *

Section 616 of the Revenue Act of 1932 was amended by section 6 (a) of the Act of Congress approved June 16, 1933 (Public, No. 73, Seventy-third Congress). In conformity with the law as so amended, Chapter V of Regulations 42, approved October 22, 1932, is amended, effective with respect to electrical energy sold on or after September 1, 1933, to read as follows:

* * * *

Art. 39. *Effective period.*—The tax applies to electrical energy sold on or after September 1, 1933, and before July 1, 1935.

Art. 40. *Scope of tax.*—The tax is imposed upon electrical energy sold for domestic or commercial consumption and not for resale, except as provided hereinafter.

The term "electrical energy sold for domestic or commercial consumption" does not include (1) electrical energy sold for industrial consumption, e.g., for use in manufacturing, processing, mining, refining, shipbuilding, building construction, irrigation, etc., or (2) that sold for other uses which likewise can not be classed as domestic or commercial, such as the electrical energy used by public utilities, waterworks, telegraph, telephone, and radio communication companies, railroads, other common carriers, educational institutions not operated for profit, churches, and charitable institutions. However, electrical energy is subject to tax if sold for use in the commercial phases of industrial or other businesses, such as in office buildings, sales and display rooms, retail stores, etc.

Where electrical energy is sold to a single consumer for two or more purposes, through separate meters, the specific use for which the energy is sold through each meter, i.e., whether for domestic or commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy used at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of this tax.

* * *

Treasury Regulations 46 (1940 ed.):

Sec. 316.190 (as amended by T. D. 5099, 1941-2 Cum. Bull. 267). *Scope of tax.*—The tax imposed by section 3411 (a) of the Internal Revenue Code, as amended, applies, except as provided hereinafter, to all electrical energy sold for domestic or commercial consumption and not for resale.

The term "electrical energy sold for domestic or commercial consumption" does not include (1) electrical energy sold for industrial consumption, e.g., for use in manufacturing, mining, refining, shipbuilding, building construction, irrigation, etc., or (2) that sold for other uses which likewise can not be classed as domestic or commercial, such as the electrical energy used by electric and gas companies, waterworks, telegraph, telephone, and radio communication companies, railroads, other similar common carriers, educational institutions not operated for private profit, churches, and charitable institutions in their operations as such. However, electrical energy is subject to tax if sold for consumption in commercial phases of industrial or other businesses, such as in office buildings, sales and display rooms, retail stores, etc., or in domestic phases, such as in dormitories or living quarters maintained by educational institutions, churches, charitable institutions, or others.

Where electrical energy is sold to a consumer for two or more purposes, through separate meters, the

specific use for which the energy is sold through each meter, i.e., whether for domestic of commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy consumed at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of this tax.

The District Court in attempting to view the problem from the standpoint of legislative intent quotes from remarks made by Senator Harrison as a member of the Senate Finance Committee in a discussion concerning a proposed revision in 1933 in which he said:

> "I am telling the Senators nothing new when I remind them that we had a fight here in 1932 over the imposition of this tax. The Senate imposed a three per cent electric energy tax, and it was finally adopted, to be collected from the consumer of electric energy. We applied that only on domestic and commercial energy: *that is, electric energy used in stores and dwellings that are classified as commercial and domestic.* There was no tax in the 1932 act imposed upon energy employed in industry." (T. 144.) (Italics supplied.)

Senator Reed also commented along the same general lines when he indicated that electrical energy sold for commercial use as well as domestic, "means that we shall get our revenue out of electricity *sold to shops and offices and places of that sort*" (75th Congressional Record, Part II, page 11608).

BRIEF FOR THE PETITIONER.

No. 237

In the Supreme Court of the United States

October Term, 1948

WISCONSIN ELECTRIC POWER COMPANY,

Petitioner,

vs.

THE UNITED STATES OF AMERICA.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF FOR THE PETITIONER

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STATUTES

MISCELLANEOUS

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BRIEF FOR THE PETITIONER

OPINIONS

One opinion was delivered by the District Court. It was written by District Judge F. Ryan Duffy and was filed December 31, 1946. It appears at page 140 of the Record and is reported in 69 F. Supp. 742. The opinion of the Circuit Court of Appeals for the Seventh Circuit (Circuit Judges Otto Kerner and Sherman Minton and District Judge Walter C. Lindley, Judge Kerner writing) was filed May 26, 1948, and appears at page 166 of the Record. It is reported in 168 F. (2d) 285. This opinion confirms and adopts the opinion of Judge Duffy.

JURISDICTION

A petition for writ of certiorari was granted by this Court on October 18, 1948. The judgment of the Circuit Court of Appeals was entered on May 26, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code (28 U.S.C.A. 347(a), and decisions thereunder determining the appropriateness of the exercise of certiorari.

Review is sought of a decision of the Circuit Court of Appeals for the Seventh Circuit conflicting with one rendered by the Circuit Court of Appeals for the Tenth Circuit on a matter of widespread importance involving the proper construction of a section of the Internal Revenue Code. The Government has not opposed such review.

STATEMENT OF THE CASE

This is a suit for the recovery of $6,806.84 (with accrued interest thereon from February 1, 1942), on the ground that such amount was unlawfully collected from the petitioner, a Wisconsin public utility corporation, as federal electrical energy excise taxes levied and collected under the direction of the Commissioner of Internal Revenue, purporting to act under Section 3411(a) of the Internal Revenue Code.

The transactions subjected to tax were sales of electrical energy by the petitioner to twenty-eight customers engaged in the dairy business in and around the cities of Milwaukee and Racine, Wisconsin, during the period of April 1, 1940, to July 31, 1943 (R. 10). As to one of these dairies the District Court found that it was not a fluid milk dealer or distributor but a manufacturer (R. 152-153). Separate meters were not installed on any of the premises of the several dairy customers so as to enable a differentiation to be made as to the precise purpose for which electrical energy was actually

consumed in the dairy operations, fifteen of the twenty eight dairies being supplied through more than one meter installation with the balance being supplied by a single meter installation for each consumer (R. 14, 147, 148). During the taxable period, the petitioner paid taxes on sales of electrical energy furnished to these twenty-eight dairy customers computed at the rate of 3% to June 30, 1940, and 3⅓% thereafter.

Each of the dairies in question engaged in the pasteurization of milk and functions normally incident to such pasteurization and the preparation of milk for sale, and used the electrical energy purchased by them from the petitioner for these several functions, which factual situation has been and now is claimed on behalf of the Government to afford the basis for the imposition of the tax.

On May 25, 1944, the petitioner filed with the Collector of Internal Revenue a claim for refund of these taxes on the ground that it had erroneously treated the sales of electrical energy as sales for domestic or commercial consumption. This claim was rejected by the Commissioner on October 16, 1944 (R. 148). The instant suit was seasonably filed on November 1, 1944, and judgment was entered for the respondent in the District Court of the United States for the Eastern District of Wisconsin on February 14, 1947, with appeal to the Circuit Court of Appeals for the Seventh Circuit, followed by judgment of affirmance on May 26, 1948 (R. 2, 9, 166).

1. Nature of the Art of Pasteurization

As indicated in the testimony of Dr. Hugo Sommer, pasteurization of milk is an activity which employs both physical and mechanical operations through the use of machinery and equipment specifically designed for the pur-

pose and entailing an investment of substantial magnitude. The cost of such equipment probably equals between 15% to 20% of the cost of all plant equipment and its necessary installation accounts for a substantial amount of space in the plant devoted solely to its functioning, or to the necessary incidents of using the pasteurization equipment, in connection with the balance of the plant equipment and machinery (R. 68, 72, 73).

By virtue of the pasteurization, milk is raised to a temperature of between 143 degrees to 145 degrees F., maintained thereat for a period of about thirty minutes, and then subjected to sudden cooling, to a point between 38 degrees to 40 degrees F., whereby certain chemical changes are induced in the milk (R. 71, 73).

Precise timing and exact temperature controls are important and the treatment of milk requires consecutive, well coordinated steps with no substantial interruption in the treatment (R. 70). The precise virtue of the specially adapted machinery and equipment is that it attains requisite heat transfer with suitable dispatch (which, of course, includes the subsequent cooling) without jeopardizing the product (R. 71). In order that such heat transfers are accomplished efficiently, mechanical and physical methods are employed to constantly change the surface of the milk to be acted upon by the heat transfer so that heating is not dependent upon convection currents within the milk fluid to effect the requisite temperature change (R. 71, 72).

According to the testimony of Dr. Sommer, the specific engineering problem governing the design of pasteurizing equipment and the objective to be achieved by the appropriate and careful use of such equipment is the application upon milk of heat of requisite intensity and for a sufficient duration as will be necessary to kill pathogenic bacteria

therein, meanwhile producing chemical changes in such milk, while staying within such tolerances as will not destroy the natural creaming properties nor impart a scorched taste to it (R. 74, 87).

An inherent attribute of the process of pasteurization includes the cooling of the milk from a fahrenheit temperature of 143 degrees to about 38 degrees (R. 68, 78). There is a desire that such cooling shall be prompt and sudden, such being the practice in most dairies, and there is a theory entertained in some respectable quarters that sudden induced cooling has a lethal effect upon such bacteria as may have escaped heat annihilation (R. 68, 76).

As part of such cooling, milk is sometimes caused to cascade down over cool surfaces to afford a form of aeration (R. 75). To permit of proper, prompt cooling, the cooling equipment of pasteurization plants must be of much greater capacity than would be the case if cooling was to be merely from the temperature of the milk upon its receipt at the plant to a proper holding temperature, as stated by Dr. Sommer (R. 67, 77).

Electrical energy is used both directly and indirectly to further the heating and cooling steps in the pasteurization process of dairy plants. Such energy is used directly for agitating the milk as well as for pumping it to and from the pasteurizing vats and is also used to pump the necessary hot water employed in raising the temperature of the milk, in pumping the refrigerant necessary for induced cooling, or pumping deep well water where that is used as part of the cooling process (R. 72, 73). Other dairy uses of electrical energy which may be classified as direct are those which assist in the rendition of by-products of pasteurization, such as the churning of butter, the preparation of skim milk, cottage cheese, cultured buttermilk, and the production of

homogenized milk, a distinctly mechanical and physical process (R. 69; 70, 76). Examples of uses of electrical energy which indirectly assist in the pasteurization process are electrical consumption for plant lighting, for boiler feed pumps and for the operation of shop tools or cleaning devices, to mention a few. Bottling devices also assist in the reception of the pasteurized milk from the pasteurizer. Petitioner has sought by means of its Exhibit 1 to demonstrate generally the relationship of pasteurizing equipment and other machinery in a dairy plant so that direct and indirect uses of electrical energy and the functional character of a pasteurizing plant will be more apparent (R. 57-123). Electrical energy is also used by the dairies for lighting administrative offices and garages, as well as all portions of the dairy plant (R. 151).

The process of pasteurization of milk results in effectively removing or controlling any bacteria content which may be present in the milk. In this manner, a consumer is protected from the baleful consequences which might otherwise follow should pathogenic bacteria exist and remain in the milk in an uninhibited condition. Another useful objective which is accomplished through milk pasteurization and the chemical changes induced thereby is the destruction of certain enzymes, naturally present in raw milk, such as lipase, which if allowed to remain would split the milk fat and give the milk a rancid odor. This result, important in the production of all milk products for use, has added significance in the preparation of homogenized milk. By the analysis of pasteurized milk for the quantitative content of the enzyme called phosphatase, the relative induced chemical change in the milk and hence the comparative efficacy of the pasteurization process for such milk can be ascertained. A secondary effect of the pasteurization is to impart to milk an enhanced preservative characteristic through the destruc-

tion of a high percentage of all bacterial content (R. 73, 81, 83). According to the belief of Dr. Sommer, no other method exists by means of which all of the beneficial attributes of pasteurization can be accomplished (R. 80).

Paragraph six of the stipulation mentions the City of Milwaukee ordinance requiring pasteurization of milk sold in the City as well as the hygienic objective thereby achieved (R. 11). Paragraph seven of such stipulation specifies the several consecutive steps in the handling of milk from its receipt, through the continuous successive temperature changes and, finally, its immediate and direct disposition into bottles or other suitable containers. The bottled milk is then placed in a storage room kept at about forty degrees fahrenheit to permit the cream line to form and held there several hours for such purpose, or up to one day if the delivery schedules of milk routes are better subserved by such additional storage time (R. 11-12). The prevailing practice is to bottle only enough milk for the next delivery requirements (R. 75).

2. Practical Aspects of Pasteurization

Dr. Sommer stated that, at least in Wisconsin, pasteurization is a typical part of the operation of every dairy plant of any consequence (R. 69). Pasteurizing plants are generally large plants tending toward substantial capacity, as compared to raw milk plants (R. 69). The concentration of milk handling machinery in sizeable plants where pasteurization of milk is a prime plant function and in a large measure regulates the other productive activities of the plant, springs largely from public reluctance to buy unpasteurized milk (R. 83). No comparable process exists (R. 87). Although hygienic control of herds and human handlers of raw milk are helpful in preventing the dissemination of

disease and contagion, they are not wholly effective, since the greatest chance of spreading milk-borne disease arises from the time of milking to the point where milk is received in the assembling plant (R. 81, 83, 89). Limited size usually characterizes raw milk distribution plants and as such organizations grow they tend to turn toward obtaining larger plants designed around the process of pasteurization. This change is encouraged and even directed by public official authority in the recognition that the relative danger from unpasteurized milk is increased with any substantial growth of raw milk plants (R. 83, 87).

The leadership of public agencies in seeking to control or minimize the distribution of raw milk and in educating the public in the salutary aspects of utilizing pasteurized milk has resulted in tangible expression by the consumer of his preference for milk so protected (R. 83). The economic aspects of pasteurization reflect this trend. Although the process was not undertaken on a widespread scale until 1897 and did not come into use in Milwaukee until 1903, by 1910 or 1915 it had become quite common to such city (R. 85). Although there were still more raw milk plants in the United States than there were pasteurizing plants, as shown by the survey set forth in Public Health Bulletin No. 245, the greater concentrated groups of population had available to them milk processed in pasteurization plants. The table shown on page 25 of the Bulletin reveals that 74.7 per cent of the total milk supply of all municipalities of over 1,000 population in the United States was protected by pasteurization. Such percentages for municipalities over 10,000 and of 500,000 and over, were respectively, 83.1 and 97.5. (Respondent's Exhibit A, R. 136).

The prevailing practice in the operation of pasteurization plants is to make disposition of the major portion of the

processed product at locations beyond the confines of the plant and to customers regularly served through a distribution facility and an organization maintained in common ownership with the plant (R. 10). The dairies utilize a system of rapid regular distribution of fresh milk to their customers and maintain fleets of trucks or other vehicles operated, serviced and maintained by employes of the dairies to effect the distribution and sale of pasteurized milk (R. 10). There may be occasional or infrequent instances where peddler routes are organized for the purpose of buying and reselling pasteurized milk but in such circumstances the milk is sold to the operators of such routes by pasteurizing plants as a mere incident of their general enterprise (R. 85, 91).

3. Facts Pertaining to the Dairy Customers of the Petitioner

The parties have sought by means of their joint stipulation of facts to produce sufficiently detailed information to enable the making of an analysis of the types of operations conducted by the several dairy plants. These plants make contracts with farm producers for purchase of daily raw milk requirements, which are sometimes delivered to the dairy plants by the producers or the dairies may through their own trucks and drivers pick up raw milk at the premises of the producer. When the raw milk reaches the plant, it is weighed, tested and mixed to obtain standard quality and passed into the pasteurization machinery or temporarily held in vats for such purpose (R. 67, 149). Exhibit A of the Stipulation shows the number of meters and the types of electrical service utilized by each of the dairy plants (R. 14). Paragraph two of the Stipulation gives additional information in respect of the electrical service furnished and points out the several types of service or optional rates which the

dairies are entitled to demand (R. 9). It is pointed out in such paragraph that the separate power meters are not so connected to the load as to enable the energy supplied for one purpose or another in the operations of the plant to be differentiated. Of the twenty-eight dairies listed, twenty are obtaining three-phase service, which is ordinarily furnished only where a power consumer has motors of substantial size and a relatively large demand for power (R. 14).

Paragraph eight of the Stipulation sets forth, in general, an outline of the general uses of electrical energy which are common to most of the plants, inclusive of lighting (R. 12). It is therein asserted that the larger dairy plants differ from the smaller chiefly in the number of units available for different operations and that in a few instances there may be additional uses of electricity, as shown in the detailed exhibits. Generally, however, electric motors are used for the following purposes, which uses are common to some or all of the plants: for pumping refrigerants, for delivering milk to, through and from the pasteurizers by pumps as necessary, for operating the homogenizer, where there is one, for delivering milk to the bottling machines, for operating cream separators, and for operating some of the machinery used in washing, sterilizing and conveying bottles.

Exhibits D to N of the Stipulation contain general information in respect of the operations of eleven specifically named plants which afford typical examples of the other seventeen plants enumerated and compared under paragraph ten of the Stipulation (R. 19-47). The exhibits show the nature of the business conducted by the several plants as to the sale of pasteurized milk and other related products, as well as the extent, if any, that other products may be sold as an incident of the operations. For example, some of

the plants bottle and sell fruit juices. To the extent that these juices are sold in the same form as when received by the plants, such handling and sale might be considered as similar to a commercial enterprise. If, however, fruit concentrates are purchased by the plants, are then mixed in the plants and bottled, such handling might, under the circumstances, be considered as a plant function rather than as a commercial function. At least in some of the plants, inclusive of the Layton Park Dairy, the latter practice prevails. (R. 93, 102).

The exhibits also show the quantity of milk received during the average day, the daily yield of the plant, both during the period of time involved in this lawsuit and the gross receipts of business in a typical year and the percentages thereof to the various products delivered from the several plants. It would seem that where the figures are available, they show that between 63 to 77 per cent of the gross receipts of the dairy plants originate from the sale of pasteurized milk. If pasteurized cream is considered along with the milk, the percentages become higher (R. 19-47).

The total personnel and their respective duties are also mentioned in the exhibits and reference is therein also made to the number of employes engaged in distributing milk who operate out of the plant, as well as those who do not come to the plant but may operate from branch distribution points. The number of conveyances used to distribute the pasteurized milk also appears upon the exhibits.

The methods employed in the distribution of milk and the operation of distribution routes with the relationship between the route men or salesmen and their customers are shown in paragraph five of the Stipulation. The entire business contact seems to be carried on by these delivery vehicle drivers while away from the plant premises (R. 10).

The petitioner has, while admitting the accuracy of the stipulated facts, objected to the introduction of the evidence as to the activities of the milk salesmen, the assignment of personnel to various activities of the dairy plants and as to their methods and results of distribution, upon the ground that such evidence is irrelevant and immaterial and not probative of the issues before the Court (R. 55, 56).

The exhibits also show the number of electric motors in use in the several plants and, where possible, the specific functions performed by such motors. By considering the capacities of the several motors in terms of kilowatt input (which is erroneously referred to in the second footnote as "output," but which does not affect the result) and the estimated number of hours of work performed by them, estimates of the relative consumption of energy for the general types of plant operations are developed. Petitioner does not concede that the facts thus developed are legally material because many of the plant functions and uses of electrical energy in the plant are so intimately connected with general plant operations, or with functions at least indirectly connected with the process of pasteurization, as to make such attempted separation lacking in reality.

The exhibits disclose that the general business of the dairies at the premises to which electric energy was furnished was the preparation of milk for market. Exhibit E shows that Luick Dairy Company had daily receipts of milk of 175,000 pounds (20,000 gals.) and that the daily yield of the plant consisted of 16,500 gallons of pasteurized milk, 800 gallons of pasteurized cream, 500 gallons of buttermilk, 1,300 pounds of cottage cheese, 1,300 gallons of chocolate milk and 500 gallons of orange drink (R. 21). The Golden Guernsey Dairy Co-Operative (Exhibit F), in addition to the dairy products produced at the Luick Dairy Company, also

had a daily yield of butter and powdered skim milk in substantial quantities (R. 25). At the Blochowiak Dairy Company (Exhibit G) the yield of butter, cottage cheese and chocolate milk constituted 30% and pasteurized milk and cream 70% of the business of the company (R. 27). The yield of the Layton Park Dairy Company (Exhibit H) was also in the proportion of 70% pasteurized milk and cream and 30% allied dairy products (R. 37). Many types of mechanical equipment are required in each of the dairy plants to which electric energy was furnished. In respect of Luick Dairy Company (Exhibit E) the tabulation shows 99 electric motors used to operate equipment required in the preparation of milk for market (R. 22). Of these 99 electric motors, a minimum of 55 are used for the operation of equipment for pasteurization of milk, separation of cream, homogenizing and manufacture of dairy products. At the Golden Guernsey Dairy Co-Operative (Exhibit F) there are listed 95 electric motors used to operate equipment of this consumer in the preparation of milk and dairy products for market (R. 25). Out of the 95 electric motors, 53 are directly associated with pasteurization of milk, separation of cream, homogenizing and manufacture of dairy products.

The extent of operations carried on at these dairy plants is best illustrated by the amount of equipment necessary to distribute the dairy products produced. The Golden Guernsey Dairy Co-Operative (Exhibit F) requires 140 trucks in daily use to deliver the dairy products procured at its plant (R. 24). The Blochowiak Dairy Company requires 30 trucks to make daily delivery of the dairy products produced at its plant (R. 27). The daily output of the Layton Park Dairy Company (Exhibit H) is delivered by 15 trucks and 5 wagons (R. 30).

Paragraph eleven of the Stipulation asserts that the

average dairy plant cost of operation amounts to about one cent per quart as compared to about four cents per quart for distribution costs of bottled milk and other products, and nine and six tenths cents per quart for the cost of raw milk (R. 13). Respondent has offered testimony by Professor William P. Mortenson to the effect that pasteurization accounts for about ten per cent of the plant costs (R. 91). This witness admitted that he knew of no plant which separated its pasteurization cost as such, and that most plants do not attempt to functionalize their accounting (R. 92, 94). The witness conceded that he had no work sheets which would substantiate his estimate, and that careful time studies would be necessary to arrive at an accurate result (R. 94). The basis of the opinion expressed was that most of the direct costs were of a small magnitude. When pressed for more details, the witness stated that while, for example, he had not attempted to segregate any of the lighting cost to pasteurization, the expense for light, power and water usually amounted to 3.3 per cent of the total operating cost, *inclusive of the cost of delivering the product* (R. 97).

The respondent offered the testimony of Joseph F. Heil to show generally the relationship of the amount of electrical energy used to supply the requisite cooling for the pasteurization process as distinguished from the amount to supply cooling for holding the milk. The estimates of the witness as to the percentage of the total electrical energy supplied for cooling which was devoted to pasteurization cooling was 32% for Layton Park Dairy, 17% for Golden Guernsey and 37% in the case of Emmer Brothers (R. 104-106). These estimates were based solely on the assumption of ideal conditions of operation for one day's operation (September 21st) and with no knowledge of the actual operations, as contrasted with the theoretical conditions as outlined in certain assumptions (R. 103, 104). The witness admitted

his inability to furnish an estimate of the connected load assignable to that portion of refrigeration used directly in the pasteurization of milk as it comes out of the vats, for example, at the Layton Dairy Plant (R. 109). He assumed a constant temperature of the holding or storage room at 37 degrees, yet pasteurization cooling to only 40 degrees (R. 112, 114). Mr. Heil, for no logical reason of his own, put all the holding tank requirements (holding of milk before pasteurization) in with the requirements for the holding or refrigeration or holding room after bottling merely because such method of approach had been suggested by counsel for the Government (R. 109). Mr. Heil conceded that considerably less cooling would be necessary in the winter time than in the summer for the refrigeration room (R. 106). The witness admitted that if the bottled milk was not held in the cooling room for any length of time, the requirements for this room would be less, yet the witness in his assumptions apparently assumed a holding temperature at full capacity maintained in this room for a whole day (R. 112, 113). The prevailing temperature during the day of the estimates was 75 degrees (R. 106). As shown by the records of the United States Bureau of Weather Statistics, the following average temperatures obtained in Milwaukee:

Yearly average	46.4 degrees Fahrenheit
July Normal	68.2 degrees Fahrenheit—highest
August Normal	67.6 degrees Fahrenheit
September Normal	61.0 degrees Fahrenheit
December Normal	24.7 degrees Fahrenheit
January Normal	19.4 degrees Fahrenheit—lowest

SPECIFICATION OF ERRORS

The Circuit Court of Appeals, in confirming the views of the District Court and in adopting its opinion, erred in the following respects:

1. In determining that because dairies buy raw milk, process it by pasteurization for disposition in channels of commerce, and sell it at the premises of customers, it can be declared that their predominant business is that of fluid milk dealers and distributors and that all of their activities, wherever pursued, are commercial in nature so that the entire use of electrical energy by such dairies, inclusive of that used for pasteurization is a commercial consumption.

2. In failing to give appropriate weight to the fact that the dairies are dependent upon the art of pasteurization, which process they employ through the use of specially designed and controlled machinery to induce chemical changes in a raw material and thereby convert it into a more refined or economically superior product, pasteurized milk, and in determining that such technology is practiced wholly incidental to a broad plan of marketing milk, analogous to a merchandising of raw milk, and, in consequence, every phase of the total activity is declared to be a component of an undertaking so predominantly commercial as to visit a status of commercial consumption upon all electrical energy employed in the aggregate enterprise.

3. In concluding, in apparent disregard of Treasury Regulations, that the incidence of the excise tax on the sale of electrical energy shall depend upon the predominant character of the integrated undertaking rather than the nature of the activity carried on at the location where the electrical energy is actually consumed.

STATUTES AND REGULATIONS INVOLVED

The issues presented arise under Section 3411 (a) of the Internal Revenue Code. The legislative history of the section and the applicable regulations are set forth in the Appendix, infra, pages 51-55, *post*.

SUMMARY OF ARGUMENT

I.

Judicial Determinations Exist to the Effect That the Pasteurization of Milk Does Not Constitute a Commercial Undertaking Although the Milk Is Subsequently Disposed of In the Channels of Commerce.

The circumstance that the ultimate disposition of a product will be its sale does not necessarily render the production thereof a commercial undertaking. (Page 20.)

In the case of *United States v. Public Service Co. of Colorado*, 143 F. (2d) 79, it was held that the pasteurization of milk in dairies was not a mere incident of a commercial undertaking, but was an industrial processing phase of an enterprise and the use of electricity therefor was not a commercial use. (Page 21.)

Pasteurization effects a change in the form of a raw material and is not a commercial activity. (Page 23.)

The commercial activities of dairies take place away from the plants. (Page 27.)

Pasteurization is an important technological process whereby through the use of mechanical and physical means a useful chemical change is induced in milk. (Page 28.)

Although the production of revenue is facilitated by the use of pasteurization, such result must be distinguished from the method employed. (Page 29.)

II.

The Regulations Have Professed to Distinguish Between What Is Commercial and What Is Non-Commercial Consumption of Electrical Energy.

The early Regulations, both when the law taxed the consumer of electrical energy as well as when it taxed the vendor, included "processing" as a non-commercial activity. (Page 32.)

Such Regulations continuing with reenactments of the Act are presumed to have had Congressional approval. (Page 34.)

The deletion of the word "processing" from the Regulations was not justified by any change in the law nor other evidence of Congressional intent and cannot affect any substantial rights of taxpayers. (Page 35.)

Regulations which are consistent with a statutory enactment continuing under subsequent reenactments are entitled to judicial recognition. (Page 36.)

The Regulations recognize "commercial" phases of non-commercial activities and the importance of determining the predominant function of the location of consumption. (Page 37.)

If such distinctions of the Regulations are to be ignored, results not originally contemplated by the Regulations nor by Congressional intent might ensue. (Page 39.)

III.

The Predominant Character of the Activities of a Dairy Plant Is Industrial Processing Rather Than Commercial.

Dairies producing pasteurized milk are not solely maintaining milk routes. (Page 41.)

The operation of a pasteurization plant is a predominant portion of a dairy enterprise. (Page 42.)

It has been factually recognized that the dairies in question conduct their commercial activities away from the pasteurization plant. (Page 43.)

The historical background of the dairy industry cannot determine its present status. (Page 44.)

The legislative history of Section 3411 (a) indicates an intention to restrict the imposition of the tax on strictly commercial undertakings. (Page 47.)

ARGUMENT

I.

Judicial Determinations Exist to the Effect That the Pasteurization of Milk Does Not Constitute a Commercial Undertaking Although the Milk Is Subsequently Disposed of In the Channels of Commerce.

The issues before the Court originate with the federal excise tax imposed upon the sale of electrical energy. To resolve such issues requires judicial inquiry into the consumption of electrical energy for pasteurization to determine whether or not it may be designated as commercial in nature. The particularly pertinent portion of Section 3411 of the Internal Revenue Code provides:

> "(a) There shall be imposed upon electrical energy sold for domestic or *commercial consumption* and not for resale a tax equivalent to 3⅓ per centum of the price for which so sold, to be paid by the vendor under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe." (Italics supplied.)

Because commodities are usually supplied in fulfillment of an economic need, it would appear to be fundamental that the production of any article, whether by means of manufacturing, processing or treatment, cannot be characterized as commercial in nature solely by reference to the circumstance that the ultimate disposition of such product will be its sale. To hold otherwise would imply that virtually every conceivable production activity was commercial in nature, which determination would clearly be contrary to Congressional intention.

In the case of *United States v. Public Service Co. of Colorado*, 143 F. (2d) 79, the Circuit Court of Appeals for the

Tenth Circuit fully analyzed the nature of pasteurization of milk and concluded that such activity was not commercial in nature. The facts of that case, as set forth on page 80 in the opinion, are as follows:

> "The stipulation discloses that the twenty dairies are each engaged principally in the business of pasteurizing, bottling and selling milk. A preponderance of the gross revenue of each is derived from the sale of pasteurized milk and cream. The supply of milk is bought from farmers and is brought to the dairy from milk stations in tank trucks and from country milk routes in cars. The raw milk is then pasteurized, bottled and sold, either at retail or wholesale. Each of the dairies also manufactures and sells ice cream and butter, but the predominant use of electrical energy is in the pasteurization of milk or some necessary operation in connection therewith, that is, cooling or refrigeration, pumping water, washing of bottles and cans."

The opinion also quotes the findings and conclusions of the trial court as follows:

> "The trial court found as a fact, 'In all of the twenty dairies, whose use of electrical energy is involved in this action, the processing and sale of pasteurized milk and cream, to render it fit for human consumption, represents the predominant character of the business * * *' and reached the following conclusion of law, 'The electrical energy involved in this action as utilized and consumed by the twenty dairies is not electrical energy sold for domestic or commercial consumption within the Act, supra, but constitutes a "process" within Article 40 of Regulations 42 adopted by the Commission of Internal Revenue * * *.'"

The opinion of the court sets forth the regulations and their history and then proceeds with an analysis of such regulations in relation to the statute which is intended to tax only *domestic* and *commercial* use of electrical energy. The reasoning of the Court is that Congress used the word "commercial" in a restricted sense which intent was initially followed by the regulations in recognizing that industrial

pursuits, which included processing, were not taxable. Further, that the ultimate aim of a pasteurizer to prepare his product to enable its subsequent sale did not justify belated efforts of the Treasury Department to now characterize processing as commercial in character so as to remove the legal effect of the previous contrary contemporary construction.

Such points are developed in the opinion in the following language:

> "In view of the admitted legislative intent, the regulation defining industrial consumption, as distinguished from commercial consumption, was appropriate. The term 'commercial' may have a broad or a narrow meaning. In its broad meaning it encompasses industrial enterprises or all business. In the narrow meaning of the term 'commercial' is included only those enterprises engaged in the buying and selling of goods. The legislative history of the Act would indicate that *Congress was using the word 'commercial' in the restricted rather than broad sense.*
>
> "(2) *The regulation classifies processing as being within the meaning of industrial.* It attempts to distinguish industrial use from commercial use. In the first part it gives a general definition of industrial use, and includes therein processing. In the second part it defines generally what is meant by commercial use. In defining these two terms it is apparent that the Treasury Department had in mind the legislative history of the Act recently passed and expressed in the regulation the intent of Congress. This regulation, while it stands, has the force and effect of law unless it is in conflict with an express statutory provision.
>
> "The regulation does not conflict with the express terms of the statute unless it may be said that processing is a commercial transaction as the term is used in the Act. *The Treasury Department for nine years did not think so.* The regulation, being a contemporary construction of the Act, is entitled to respectful consideration and is not to be overruled except for weighty reasons.

"The contention of the government now would seem to be that the regulation is invalid unless the word processing be interpreted as synonymous with manufacturing. The government now argues that none of the dairies 'derived its receipts directly from pasteurization of milk or carried pasteurization on as a business,' but that pasteurization was merely an incident to the main enterprise of selling and distributing milk. With equal force, it might be contended that manufacturing is but an incident to the main business of the manufacturer, to-wit, the selling of the manufactured article. In the final analysis all business is commercial. *If the ultimate aim of industry is the test to be used in determining whether or not electrical energy used in the industry is taxable, all such energy would be taxable; and the admitted intent of Congress would be defeated.*" (Italics supplied.)

The nature of pasteurization was set forth by the Court as follows:

"(4) It will be assumed that the Treasury Department in the use of the word 'processing' in the regulation used it in its ordinary meaning. Webster defines 'process' as follows:

> 'to subject (especially raw materials) to a process of manufacture, development, preparation for the market, etc.; to convert into marketable form, as livestock by slaughtering, grain by milling, cotton by spinning, *milk by pasteurizing*, fruit and vegetables by sorting and repacking.' (Italics supplied.)

"The courts have generally accepted this definition. The Michigan court in *Michigan Allied Dairy Ass'n. v. Auditor Gen.*, refers to pasteurizing of milk as 'industrial processing.' Pasteurizing milk is 'processing' as the term is ordinarily understood."

The transformation of a raw material, as accomplished by pasteurizing, was recognized by the Court as an industrial pursuit, the opinion concluding:

"(5) * * * Aside from the regulation, however, the electrical energy is exempt. It was not sold for com-

mercial consumption within the meaning of the Act. All industry in a sense is commercial, but admittedly industrial consumption is not included. A manufacturer intends ultimately to sell his goods—his income is derived from the sale of his product. True, the twenty dairies were buying and selling milk, but they were doing more—they were processing—pasteurizing raw milk in preparation for the market. Although the product sold was milk, it was not raw milk. The electrical energy was not used in the commercial phase of the dairying enterprise, but in the processing or industrial phase of the enterprise."

The Supreme Court of Michigan has had before it the question of whether the pasteurization of milk is industrial processing. That court has not only decided such question in the affirmative but has also determined that in view of the method by which a dairy operation is conducted, the use of bottles and cans for the reception of the pasteurized milk is in reality a part of the industrial process and such containers are for that reason exempt from the use tax. The pertinent language of the Court in the case of *Michigan Allied Dairy Ass'n, v. Auditor General, et al.*, 302 Mich. 643, 5 N. W. (2d) 516, 517-518, is as follows:

"Section 4 of the Use Tax Act, supra, provides that it shall not apply to '(g) Property sold to a buyer for consumption or use in industrial processing or agricultural producing.'

"The question may be resolved into whether milk bottles and cans purchased by milk processors are used in industrial processing, or whether they only are convenient containers in which to deliver the contents. * * *

* * * * *

"* * * We principally confine our discussion to whether milk bottles and cans are used by dairies and creameries for such industrial processing as is exempted by the general sales and use tax acts. After raw milk reaches the dairy or creamery plant and after it has been tested for butter fat content, inspected for

flavor and condition, sampled for chemical content, weighed and emptied into special receiving equipment, it is then treated or handled in two steps. First: It is heated to just over 142 deg. Fahrenheit and kept at that temperature for at least thirty minutes. It is then properly cooled to 50 deg. F. or lower, and as a rule to 40 deg. F., the latter being the lowest temperature at which it can be poured into bottles without foaming. Second: The milk is then poured into bottles or cans emerging from a sterilization chamber at about 80 deg. F., the heat of the bottles causing the temperature of the milk to rise by about 8 deg. F. The bottles are capped, the milk cooled in the bottles to just over 32 deg. F. (freezing), then held at that temperature for the period (as a rule longer than 12 hours) prior to being loaded on wagons for delivery to consumers. By the first step about 99 per cent. of the pathogenic bacteria are killed immediately; by the second step the remaining 1 per cent. is rendered inactive and slowly killed.

"By retaining the capped bottles of milk and cans in a refrigeration room for at least 12 hours, and then delivering them in a cooled condition to the consumers, the milk is kept fresh and free from germs. During the prolonged period of refrigeration in the bottles and cans, the cream line forms and deepens so that the public can see the amount of cream in the bottles. This is one of the conditions of marketability of bottled milk. If the 1 per cent. of germ life not destroyed by the heating process in the first step were left at normal temperature, the bacteria would multiply very rapidly and cause the milk to sour. Only refrigeration for a long period before being put on delivery wagons enables the milk to remain free from bacteria and from souring during the interval between the time the milk leaves the refrigeration room of the creamery until it is placed in the consumer's ice box. These facts were brought out by opinions of five expert witnesses for plaintiff but were in part contradicted by the opinion of one expert for defendant. We are impressed with the opinions of plaintiff's witnesses, not their number. Defendant's witness testified that the refrigeration does not constitute industrial processing.

"The Supreme Court of Arizona, in construing the

word 'processing' in the Arizona Privilege Sales Tax Act, stated: 'It will be seen that the essential portion of the definition is to "prepare raw material * * * for the market * * *."' *Moore v. Farmers Mutual Mfg. Co. & Ginning Co.*, 51 Ariz. 378, 382, 77 P. (2d) 209, 211, 212.

"*Milk is not marketable until rendered suitable for purchase and consumption from the point of view of the consumer*, for only milk, which, after pasteurization, has been cooled and protected against subsequent contamination or deterioration may be used with confidence that it has been rendered safe as regards pathogenic bacteria.' *Lang's Creamery v. City of Niagara Falls*, 251 N. Y. 343, 344, 167 N. E. 464, 465.

"The Attorney General calls attention to *City of Louisville v. Ewing Von-Allmen Dairy Co.*, 268 Ky. 652, 105 S. W. (2d) 801; *City of Richmond v. Richmond Dairy Co.*, 156 Va. 63, 157 S. E. 728, and *Anheuser-Busch Brewing Association v. United States*, 207 U. S. 558, 562, 28 S. Ct. 204, 52 L. ed. 336, which hold that pasteurization does not constitute a manufacturing process. *These cases do not distinguish between manufacturing processing and industrial processing.* Pasteurization followed by prolonged refrigeration manufactures no new article, but frees the milk from bacteria and keeps it free thereof until it reaches the consumer. To accomplish this it is necessary to put the milk in bottles immediately after it has been subjected to heating. The peculiarities of milk are such that, if it were immediately cooled to just above freezing before being poured into the bottles, foam would form so that the bottles would not be full. While it might be suggested that the milk might be stored in refrigerated vats and put into cool sterilized bottles and cans just before leaving the creamery and thus possibly avoid the growth of bacteria, nevertheless, this would be a less practicable way of handling milk. In any event, we are only considering the accepted practice as disclosed by the record. *We hold that the use of bottles and cans is part of the industrial processing of milk.*" (Italics supplied.)

The definition of processing as being inclusive of the pasteurizing of milk ("to subject (especially raw materials)

to a process of manufacture, development, preparation for the market, etc.; to convert into marketable form, * * *" which was quoted with approval in the *Colorado case*, by the Tenth Circuit Court of Appeals, has also received recognition in other courts.

Moore v. Farmers Mut. Mfg. Co., 51 Ariz. 378, 77 Pac. (2d) 209.

Bedford v. Colorado Fuel & Iron Co., 102 Col. 538, 61 Pac. (2d) 752.

Bald Mountain Mining Co. v. Walsh, 65 S. D. 117, 271 N. W. 819.

Kennedy v. State Board of Assessment and Review, 224 Iowa 405, 276 N. W. 205.

Nye & Nisson v. Wood Lbr. Co., 92 Cal. App. 598, 268 Pac. 659.

Colbert Mill & Feed Co. v. Oklahoma Tax Comm., 168 Okla. 366, 109 Pac. (2d) 504.

Chickasha Cotton Oil Co. v. Cotton County Gin Co., 40 Fed. (2d) 846, (C.C.A. 10th).

Pasteurization cannot be truly characterized as a commercial activity solely by virtue of the fact that the milk is ultimately disposed of in channels of commerce. As shown by paragraph 5 of the Stipulation, practically all of the sales of milk and cream and the financial details in connection therewith, including collections, occur outside of the premises to which the electrical energy is furnished. Most of the retail sales are initiated, negotiated and accepted at the customer's home, with payments collected from the customer at his door, adjustments made there and most of the elements of a commercial transactions completed there, thus removing the incidence of sales and collection away from the dairy plant. The more usual connotation of "commercial" activity is the exchange, or in other words, the buying and selling of goods. *Jordon v. K. Tashiro*, 278 U. S. 123, 127, 73 L. ed. 214.

In the case of *Utah Power and Light Co. v. Pfost,* (D.C., D., Idaho, S.D.) 52 F. (2d) 226 at page 234 it was said:

> "* * * There is a distinction between production and commerce, as commerce succeeds production and is not a part of it. Production or manufacture is a transformation of raw material into a change of form for use, while the functions of commerce consist in the purchasing, selling, and exchanging of commodities and the transportation incidental thereto. Hammer v. Dagenhart et al, 247 U. S. 251, 38 S. Ct. 529, 62 L. Ed. 1101, 3 A. L. R. 649, Ann. Cas. 1918E, 724."

Pasteurization, rather than being commercial, partakes of the nature of an industrial processing activity. Considerably expensive and specialized equipment and machinery is required for milk pasteurization and its preparation for market. This occurs because the pasteurization process is in itself primarily a mechanical and physical operation, resulting in inducing desirable chemical changes in the product, in which the results are accomplished with the use of a small amount of labor compared to other milk handling operations in connection with a dairy plant. Skilled operators must attend to the pasteurization equipment but their efforts are directed mainly toward starting and stopping the equipment, watching and regulating the operations of the various machines. The pasteurization process itself is composed of work performed upon the milk by machines such as milk pumps, agitators, tanks for holding and pipes for moving milk from place to place and of applications of heat and cold, both of which are generated by other mechanical equipment. Thus, the process employs elaborate equipment, in which the investment is substantial, yet comparatively small operating costs are incurred. With labor at present-day wage rates being so large a factor of operating expense, the economical expenditure of labor costs in pasteurization operations results in low plant costs for such activity, compared to other dairy plant functions where

considerably more manual labor is required. In the courts below the argument on behalf of the respondent has attempted to minimize the relative importance of pasteurization by showing that it is conducted at a cost which is small compared to the value of raw milk and in comparison to merchandising costs for selling pasteurized milk. Such a comparison, however, is an imperfect one unless it is considered in conjunction with the amount of elaborate equipment devoted to pasteurization and the high investment made therein, which performs a vital function with a limited amount of direct labor.

The implied claim on behalf of the respondent in this case that all of the plant activities are related to a commercial enterprise denies the realities which exist. It is the essential character and nature of the technical operations involved which should determine the kind of activity which is being carried on. Even though the major portion of the receipts is ultimately obtained from the sale of a product called milk, it is not the same commodity as the original product, raw milk. As was said in the case of *H. P. Hood & Sons v. Commonwealth*, 235 Mass. 572, 127 N. E. 497:

> "It then pasteurizes the milk, which is a subjection of it to heat for the purpose of inducing certain chemical changes."

If this case should be decided in favor of the respondent merely because the dairies which used the electrical energy carried on sales activities beyond the premises where the energy was consumed, such decision would of necessity carry with it every industrial plant which maintained a sales organization, whether on or off its main premises. The Courts have not, however, given such a wide definition nor scope to the word "commercial." In the case of *State ex rel. Kansas City Light and Power Co. v. Smith*, 342 Mo. 75, 111 S. W. (2d) 513, the contention was raised that a statute

imposing a tax upon "sales of electricity or electrical current * * * to domestic, commercial, or industrial consumers" covered sale to and use by a streetcar company of electrical energy to propel its streetcars on the principal ground that the term "commercial" included everything relating to commerce. In denying this contention, the court said:

> "If appellant is correct in his contention that the word 'commercial' includes everything pertaining to commerce, then it would also include industrial pursuits; for instance, a shoe manufacturer is engaged in an industrial pursuit in making and selling shoes. If 'commercial' is used in its broad sense, it includes also the word 'industrial.' This the appellant admits, for in his brief he says. 'We respectfully urge upon this court that the term "commercial" as used in this act, might include in its scope "industrial" for both are closely associated; "commercial" includes "industrial".' If the word 'commercial' includes 'industrial,' then why did the Legislature use the word 'industrial' also? We have already seen that every word should be given a meaning in construing a statute if possible; we therefore conclude that the word 'commercial' was not used by the Legislature with the intention of including the word 'industrial.' Both were used in the Act, not in the broad sense, but, rather, in a restricted sense.
>
> "The ordinarily accepted use of the phrase 'commercial establishment' denotes a place where commodities are exchanged, bought, or sold, while the ordinarily accepted meaning of the phrase 'industrial establishment' denotes a place of business 'which employs much labor and capital and is a distinct branch of trade; as, the sugar industry.' Webster's New International Dictionary. Thus, we see that the transportation of passengers would not come within the ordinary meaning of either the word 'commercial' or 'industrial'."

The Missouri Court had no trouble in differentiating between the words "commercial" and "industrial" when they were used in the same statute by employing a canon of construction that every word used in a statute should be given its appropriate significance where possible. The distinction

between the two words is even more apparent where the statute, instead of imposing a tax on the activities included in each word, makes the pursuits within the scope of one word taxable yet withholds as not taxable those callings which are within the ambit of the other word. This does not constitute the creation of an exemption but instead is a legislative mandate to refrain from taxing. Both on the basis of the character and nature of the process of milk pasteurization in its relation to industrial activity and upon the authority of court decisions, a commercial activity is not involved because the product finds its way into economic channels.

II.

The Regulations Have Professed to Distinguish Between What Is Commercial and What Is Non-Commercial Consumption of Electrical Energy.

Originally, the tax on electrical energy, as created by Section 616 (a) of the Revenue Act of 1932, was a tax upon the consumer, though collected by the Vendor. It was imposed and to be collected "for electrical energy *for domestic or commercial consumption* furnished, etc." The Regulations initially promulgated for the administration of this law were in all essential respects similar to those which were subesquently issued when, by amendment in 1933, the law converted the tax to one upon the vendor instead of upon the consumer. Regulation 42, Article 40, as applicable to this tax when it was one upon the consumer, contained the following language:

> "All electrical energy furnished the consumer is taxable except (1) electrical energy furnished for industrial, *e.g.*, that used in manufacturing, *processing*, mining, refining, shipbuilding, building construction,

etc; and (2) that furnished for other uses which likewise cannot be classed as domestic or commercial, such as used by public utilities, water works, irrigation companies, telegraph, telephone, and radio communication companies, railroads, other common carriers, educational institutions not operated for private profit, churches, and charitable institutions. *However, electrical energy is subject to tax if consumed in the commercial phases of industrial or other businesses, such as in office buildings, sales and display rooms, retail stores, etc.*

"Where electrical energy is supplied to a single consumer for two or more purposes, the specific use for which the energy is furnished, *i.e.*, whether for domestic or commercial consumption, or other consumption, shall determine its taxable status. Where the consumer has all the electrical energy used at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of electrical consumption for the purposes of this tax." (Italics supplied)

With the early law and regulations in the form as stated above, the distinctions between commercial and other than commercial uses of electrical energy were sharply maintained throughout such regulations at the time when the law imposed the tax upon the purchaser of such electrical energy rather than upon the supplier. As will be subsequently shown, the change in the law so as to make the burden of the tax fall upon the vendor of the electrical energy did not change other fundamental concepts of the law itself and the segregation of *domestic* and *commercial* consumption as being the only taxable transactions was preserved. Although new regulations were then promulgated to recognize the vendor as the new taxpayer in lieu of his former status of a mere collecting agent for such tax, the distinction of commercial uses of electrical energy as being the only type of business activity sought to be made taxable was preserved in such regulations. The same types

of recognized industrial activities were defined as not being within the scope of commercial pursuits, including *processing.*

The regulations revised to conform with the law as amended in 1933 preserved the form of illustrating by specific enumeration uses of electrical energy which were considered non-commercial. Article 40 of Regulation 42 read as follows:

> "Scope of tax—The tax is imposed upon electrical energy sold for domestic or commercial consumption and not for resale, except as provided hereinafter.
>
> "The term 'electrical energy sold for domestic or commercial consumption' does not include (1) electrical energy sold for industrial consumption, *e.g.*, for use in manufacturing, *processing,* mining, refining, shipbuilding, building construction, irrigation, etc., or (2) that sold for other uses which likewise cannot be classed as domestic or commercial, such as the electrical energy used by public utilities; water works, telegraph, telephone, and radio communication companies, railroads, other common carriers, educational institutions, not operated for profit, churches, and charitable institutions. However, electrical energy is subject to tax if sold for use in the commercial phases of industrial or other businesses, such as in office buildings, sales and display rooms, retail stores, etc.
>
> "Where electrical energy is sold to a single consumer for two or more purposes, through separate meters, the specific use for which the energy is sold through each meter, *i.e.*, whether for domestic or commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy used at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of this tax." (Italics supplied)

Until a change in the Regulations occurred on November 28, 1941, the Regulations continued in the form as

next above stated. On such date, Regulation 46, Section 316.190 (T. D. 5099) was created as the now applicable Regulation. Such new regulation differed from its predecessor in that the word "processing" was omitted from the classification of activities specifically enumerated as non-commercial. Such deletion was held by the Circuit Court of Appeals for the Tenth Circuit to be ineffective to place pasteurization (admittedly a process) into a commercial category. That court said in the case of *United States v. Public Service Co. of Colorado*, 143 F. (2d) 79 at page 81:

> "The regulation does not conflict with the express terms of the statute unless it may be said that processing is a commercial transaction as the term is used in the Act. The Treasury Department for nine years did not think so. The regulation, being a contemporary construction of the Act, is entitled to respectful consideration and is not to be overruled except for weighty reasons."

During the nine year interval when the word "processing" was included in the Regulations, Congress, by five separate provisions[1] continued the legislation, which is the basis of the Regulations. The continuance of the law through amendment, extension or reenactment of the statute was accomplished without any relevant, substantial change in the law which the Regulations purport to construe. It must be presumed that Congress adopted and approved the form and content of such Regulations and did not countenance any change. Under such circumstances, any change

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[1] 1932 Act. Sec. 616 (a) (As amended by Sec. 6 (a) of Public No. 73—73rd Congress, approved June 16, 1933, and effective September 1, 1933.)
Reenacted as Sec. 3411, I.R.C. (for energy sold on or after Sept. 1, 1933, and before July 1, 1937.)
Section 713 of the 1938 Act.
Public Resolution 48 (Extended tax to July 1, 1939—approved June 29, 1937.)
Reenacted as Sec. 3411 I.R.C. (By Sec. 210, 1940 Act—changed rate to 3½% to June 30, 1945.)
Sec. 521 (a) (19) 1941 Act.

without Congressional approval or without any foundation in any difference in the law, amounts to a form of improper administrative legislation.

The newly created Regulation professed no significant changes except that for the first time the word "processing" was deleted. Such revision of a regulation which had been permitted to exist for more than nine years is not accounted for by any change in the law nor any other evidence of Congressional displeasure with the previously existing form of the regulation. Nothing has intervened to justify any change in the regulation as might have the effect of changing applicable rules. The commencement of the *Colorado Public Service Company case* would not afford such a justification. A portion of the taxable period involved in the instant controversy existed under the former Regulation.

A change in theory now entertained on behalf of the Commissioner would not sanction such departure from the fundamental precepts of fair play. To hold otherwise would seem to permit the Commissioner to arrogate to himself the original power to legislate. If so vast a power can be accorded to an administrative official, the sanctity of a statute exists solely in its form, not in its substance. The statute itself would have to step aside for each whim entertained by a commissioner.

Regulations adopted by the Commissioner, with the approval of the Secretary of the Treasury, as authorized by law originally, are to be taken and accepted as reflecting the original Congressional intent, which is especially true where Congress, after the initial promulgation of the Regulations in question, has amended, extended or reenacted the statute which afforded the only basis for the Regulations, without altering or modifying, in any manner, the language of the statute as first construed by the Regulation.

Such regulations continuing under reenactment of a specific act are not subject to judicial disregard except for reasons of substance. In the case of *Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, v. Robert C. Winmill,* 305 U. S. 79 at page 83, it was said:

> "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law.
>
> "There has been tacit, if not express judicial approval for the administrative treatment of commissions as an element of the cost of securities."

See also *Thomas W. White et al, former Collector of Internal Revenue for the District of Massachusetts, Petitioner, v. Winchester Country Club,* 315 U. S. 32 at 41.

It is submitted, however, that the original regulations were consistent with the statute as originally created and as now existing. Such Regulations admitted of a precise and definite administration of the law. The law sought and still seeks to tax only that which is truly commercial. All other business activities were not merely exempt; they were not subjected to tax. The Regulations, simply for ease of definition, attempted to classify certain admitted non-commercial activities as not being covered by the taxing statute. In such classification it was recognized that "commercial phases" existing somewhere in every business activity, did not render taxable that which was not originally intended to be included for taxation. Among the specific activities recognized as being in the nature of non-commercial undertakings, was processing. Because the lexicographers and courts recognize milk pasteurization as a form of processing and because the courts have further determined that it partakes of industrial activities, rule changes are now attempted which will change a practical result, though not

altering fundamental concepts. Such a change is one which should only be made by Congress.

It is noteworthy that, when the tax was still one imposed upon the purchaser of electrical energy, the activity on behalf of the Government was not confined to carefully preserving in the regulations the distinction between, on the one hand, commercial activities, and on the other, non-commercial functions, inclusive of processing. It was at this time that the following ruling, which though subsequently changed, was issued which clearly recognized the inherent nature of milk pasteurization as an industrial process by direct language:

> S. T. 518 Internal Revenue Bulletin XI "1, Cum. Bull. 11-2 page 498, October 7, 1932.
>
> "Electrical energy furnished for consumption by bottling works, milk companies, or creameries engaged in the pasteurization and bottling of milk and in manufacture of butter, buttermilk, chocolate milk, and cottage cheese is not furnished for domestic or commercial consumption and is not subject to the tax imposed by Section 616 of the Revenue Act of 1932. However the use of electrical energy in branch offices or agencies of such industries is a commercial use and electrical energy so used is subject to the tax."

Though such last quoted ruling might be informally cast aside with the same apparent facility with which the Commissioner has taken action of denial in the instant case, the Regulations are promulgated on a higher and more dignified plane, "with the approval of the Secretary" (Sec. 3450 of Internal Revenue Code) and may not be arbitrarily and summarily changed nor disregarded. This is especially true where they have received implied Congressional approval as occurs when Congress reenacts an existing statute.

The Regulations have sought to preserve the distinction between commercial and non-commercial undertakings not alone by means of using the device of an express definition

but also by recognizing that even industrial enterprises will have a "commercial" phase, the existence of which, however, cannot have the office of determining the inherent nature of the type of pursuit being inquired into. If such were not the case, the production of all commodities for ultimate sale would be declared commercial in nature and the intention of Congress thereby defeated. In the field of business enterprise, Congress intended to include *only* commercial undertakings within the scope of the tax. Industrial and other non-commercial activity was not left in such position that it might be capable of winning an exemption only by the use of requisite proof. It was simply not covered by the tax.

Section 316.190 of Treasury Regulations 46 (Appendix, page 54), following the statutory pattern, contains an introductory statement singling out for taxability all energy sold for domestic or commercial consumption except as otherwise provided, and thereafter details certain categories of use which are admittedly neither domestic nor commercial. Thereafter, the Regulation recognizes that certain commercial or domestic "phases" may exist at a given location as a part of an enterprise which would not generally be subject to tax, stating:

> "* * * However, electrical energy is subject to tax if sold for consumption in commercial phases of industrial or other business, such as in office buildings, sales and display rooms, retail stores, etc., or in domestic phases, such as in dormitories or living quarters maintained by educational institutions, churches, charitable institutions, or others."

Finally, the Regulation directs inquiry, independently of the over-all undertaking of the customer, into the predominant function carried on at the *location of consumption*, declaring:

> "Where electrical energy is sold to a consumer for

two or more purposes, through separate meters, the specific use for which the energy is sold through each meter, i.e., whether for domestic or commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy consumed at a given location furnished through one meter, *the predominant character* of the business carried on *at such location* shall determine the classification of consumption for the purposes of this tax."

The Circuit Court of Appeals in the instant case, in adopting the finding of fact and opinion of the District Court, determined the issue of taxability by stating the governing principle of law to be:

> "* * * The incidence of the tax did not depend upon the particular operation in which the energy was used, but upon the business of which it formed a part, and that since the predominant business of the dairies was that of fluid milk dealers and distributors, the electricity sold to the dairies by plaintiff was sold for commercial consumption." (R. 167)

Assuming that historically the present dairy plant bears some relation to the early milk routes along which raw milk was sold and that there are still in existence dealers in raw milk, the dairy plants consuming the electrical energy furnished by the petitioner should not be governed by such analogy merely because the product sold in all enterprises compared can be classified as milk, or because all of the undertakings have had a commercial phase.

Results not contemplated by the Regulations could reasonably be expected to follow if the language of the Circuit Court of Appeals' decision represents the governing rule. From such language the classification of taxability would be dependent upon the consumer's business as an entirety rather than upon the nature of the consumption at each separately metered location. Thus, in the case of an enterprise clearly industrial in character, such as that of a large steel producer, energy consumed would be presumably nontaxable even though supplied at a location such as an office

building where commercial activities were predominant. On the other hand, energy supplied to a textile mill, owned by a chain store organization which sold at various retail stores the entire output of the mill, would become taxable as commercially consumed energy utilized by a predominantly commercial undertaking. Both of such results, while in accordance with the language of the court decision, would seem to be contrary to the concepts of the Regulation.

Moreover, the language of the decision from the Seventh Circuit, which places extreme emphasis upon the commercial phase of a dairy, could logically be employed to extend the Act so as to operate upon a factual situation never intended by Congress to be taxable and not comprehended by the Regulations as commercial. Thus, should one of the Wisconsin dairies in question own and maintain its own herd of cattle at a location naturally removed from the dairy plant, own either directly or indirectly an electrical distribution system from farm to pasteurization plant, own a bottle manufacturing plant separately located, and own a geographically separated ice manufacturing plant, all of which facilities were entirely used by the dairy in the furtherance of its business of supplying pasteurized milk to others, and should each be separately metered, the language of the decision would be sufficiently extensive to render each of the separate pursuits a taxable function. Certainly, the Regulations do not purport to extend the law to such limits.

III.

The Predominant Character of the Activities of a Dairy Plant Is Industrial Processing Rather Than Commercial.

The Circuit Court of Appeals confirmed the determination and adopted the opinion of the District Court to the effect that dairies are primarily commercial institutions

and, therefore, a sale of electrical energy to them was held to be a taxable incident. The District Court arrived at this holding because it concluded that the business of dairies was "predominantly that of fluid milk dealers and distributors." In expanding the reasoning the Court said:

> "It seems quite clear that a dairy which does not pasteurize its milk conducts a commercial business. The fact that some dairies do pasteurize their milk does not thereby change the business from commercial to industrial." (R. 143)

Although, as pointed out by the District Court, milk routes still exist whereby raw milk is offered to a customer, such circumstance does not characterize the instant dairy plants as being, through the affinity of relationship, commercial in nature. The instant record demonstrates that pasteurization is a technical procedure requiring precise handling of specially constructed machinery. The resulting product is in fact chemically different than raw milk. Where the art of pasteurization is employed, all portions of the plant are coordinated and in a large measure dependent upon the working of the pasteurization equipment. Pasteurization plants are generally large in capacity compared to raw milk plants because in this manner the relatively high investment in pasteurizing machinery may be economically utilized (R. 69).

The dairy plants whose operations give rise to the questions to be decided by the Court varied considerably in their relative size or the extent of their several operations. Whether they were large or small, however, the common denominator of all was the use of specialized machinery and the product processed, in the main, fluid milk. Perhaps the smallest operation reviewed was the Rolland J. Ruby plant (Exhibit K, R. 40) where 80% of the milk received was produced on the farm where the plant was located with the remainder acquired through purchase. The importance

of the pasteurization is illustrated by the practice of this modest establishment, in that all but 5% of the milk sold is pasteurized. If pasteurization were not such an important activity, even though the operation in the case of the Ruby plant is relatively small when compared to the large dairy plants, the milk handled (3,000 pounds per day, of which 2,400 was locally produced) would most likely be sold as raw milk to some larger plant for processing and distributing. This plant was certainly organized for processing, and except for size, its operations are similar to those of a plant of large productive capacity. The operation of the plant is a predominant portion of the business.

Except to the extent that the nature of pasteurized milk may determine the main issue one way or the other, there is no substantial commercial activity at the plant on the part of any of the dairies whose operations are presently involved. They either sell products wholly processed by themselves or, in one or two instances, sell mainly such products with a nominal amount of sales of products which they purchase for resale.

In the instant case, despite the determination of the courts below that the dairies were commercial institutions, the commercial aspects of the business were primarily carried on away from the premises where the electrical energy was consumed. Thus, Finding of Fact number eight states:

> "8. For all the operations described in the preceding paragraph hereof, each dairy maintains a fleet of trucks and other vehicles and drivers. In most cases, the drivers have standing orders to deliver specified amounts of milk each day. In other cases, the amounts are specified at the time of delivery. The drivers also collect for the milk delivered, obtaining payment from some customers in advance for the milk, from some at the time of delivery, and from some by the week." (R. 199)

A portion of Finding of Fact number seven, which further demonstrates that the commercial activities of the dairies are not carried on at the plants, states:

> "* * *. Except as retail or wholesale depots are maintained, or as deliveries are made to stores, each of the dairies delivers its milk and other dairy products directly to consumers by use of the horse-drawn vehicles and trucks." (R. 149)

The opinion of the District Court also recognizes that the commercial activities were pursued by the dairies away from their plant locations (R. 141). The exhibits attached to the Stipulation of Facts (R. 19-48) show in detail that the plants are not the locations of commercial sales. In only one instance are there any direct sales on the premises where in the case of a small dairy the stipulation states:

> "A retail store maintained in the front of the plant building sells about 25 per cent of the ice cream and a very small per cent of the milk pasteurized and bottled." (Exhibit 1, R. 33.)

On the other hand, in the instance of at least one large dairy, the stipulation recites, "This company also has three distribution branches at other locations in the city, for which no exemption from tax is claimed, and a part of each day's output of this plant is delivered to these three distribution branches after being bottled or packaged" (Exhibit E, R. 121).

Under the law and under the Regulations, it is legally immaterial that the dairy plants also manage milk delivery routes. Such necessary "commercial phases" of their activities do not make these plants commercial in nature. The design to process milk by pasteurization to enable it to have a higher economic value does not reduce the whole activity to one of merely buying and selling or exchanging goods. Moreover, in a true and realistic sense, the activities of the milk routes, except as to the original loading of the vehicles,

take place outside of the location of the plant. The predominant character of the business carried on at the location of the plant is not the sale of milk but is industrial processing in the form of pasteurization.

The humble beginnings of the dairy industry in the peddler milk route should not be permitted to wholly determine the instant issue. Many other admittedly industrial pursuits now employing advanced technological skill and complex machinery once had their origin in directly satisfying the wants of a few customers. For example, it seems beyond any question of dispute that the manufacture of shoes is an intricate industrial function, the primary objective being to make shoes to sell. Before the advent of shoe machinery, however, the shoemaker, employing only a few small hand tools, was able to turn out a product for his customers. Firearms, which are now made through the use of precision machinery, were once made by the hand artisan. It may be that in both examples, instances still exist where a highly specialized craftsman may turn out either firearms or shoes for specialized customers. The majority of our present industrial undertakings sprang from humble beginnings but they are nonetheless industrial even though a product in some respects similar to that produced by the large manufacturers could be made by hand and sold directly to a few customers. Instances have not been unknown wherein a seller has offered a product for sale which has been assembled by him wholly out of prefabricated parts which he has purchased under contract. Such assembler is nonetheless engaged in an industrial pursuit in the same manner as is his competitor who manufactures the majority of the parts embodied in the finished article. Nor is there any true distinction in the fact that some products produced by industry are consumer goods, whereas others are durable or capital goods. Technological processes and com-

plex machinery may be employed for the production of both types of commodities.

The District Court concluded that its determination would be contrary to that of the case of *United States v. Public Service Co. of Colorado* (10th Circuit), 143 F. (2d) 79, and particularly with the pronouncement therein to the effect that:

> "The electrical energy was not used in the commercial phase of the dairying enterprise, but in the processing or industrial phase of the enterprise."

The District Court concluded that the *Colorado case* had been erroneously decided and, accordingly, refused to recognize it as authoritative. Having determined from the reasoning employed that the predominant nature of the business of dairies was commercial, the District Court then concluded on the authority of the case of *St. Louis Refrigerating and Cold Storage Co. v. United States*, 43 F. Supp. 476, that all electrical energy furnished should be regarded as taxable. It is now submitted, however, that such case is not an answer to the instant situation. The figures inherent in that case are set forth at page 479 thereof and clearly show the commercial aspect of the business there being considered. Moreover, in special finding of fact No. 20 the letter of the Commissioner is included wherein the Commissioner asserted the taxability of electrical energy because it was "not used in manufacturing or processing articles of commerce," the entire excerpted portion of such finding at page 480 being:

> "October 3, 1932, the Commissioner wrote the New York State Association of Refrigerated Warehouses, in reference to the electrical energy tax, in part as follows:
>
> 'You are advised that the question of the taxable status of electrical energy which is furnished to public cold storage warehouses has been reconsidered and the

> Bureau is now of the opinion that the consumption of electrical energy in operating compressors in the manufacture of refrigeration for storage purposes is commercial in scope, *since such energy is not used in manufacturing or processing articles of commerce,* and, therefore, is subject to the tax imposed by the above-named section (Sec. 616)'." (Italics supplied)

Although the Treasury Department has evolved what is characterized as the "gross receipts test" to determine the relative magnitude of commercial activity, such rule of thumb does not solve the present issues. The test calls for the ascertainment of the amount of gross revenue derived from the several activities, and if those which are clearly commercial predominate in the production of such revenue, the entire undertaking is thought to be commercial in nature. Under this pattern, the sale of pasteurized milk constitutes the source of most of the gross revenues of each of the dairy plants, and unless the nature of pasteurized milk is such that its sale renders a plant wholly commercial in nature, the taxpayer must prevail.

Over objection, Mr. Manning, an Internal Revenue Agent, was permitted to testify on behalf of the respondent concerning the alleged applicability of "the gross receipts method" as a means of ascertaining whether or not electrical energy sold to a dairy was taxable. His testimony in this respect may be summed up by the following answer:

> "A. We would ascertain the quantity of sales of manufactured products and the amount of sales of fluid milk and whichever was larger would determine the taxability of the account." (R. 117)

The scope of the application of such test, in reference to pasteurized milk, was demonstrated by the following question and answer:

> "Q. Now, when you speak of the gross receipts test and use fluid milk precisely, you assume that in that thinking so far as you are doing the approach to the

matter, that regardless of what took place in the pasteurizing vats that entire commodity or product is, nevertheless, still a product similar to what it would be were it to be sold as raw milk?

"A. That is right." (R. 118)

Nowhere in the law, nor for that matter within the permissible scope of the Regulations is there any such justification for completely ignoring the true nature of the process of pasteurization. Pasteurization in the modern dairy is much more than a mere incidental and casual activity. It is the central activity around which turn the other activities of the pursuit. The other operations of the dairy plant, such as cream separating, the rendition of by-products and the bottling of the milk itself must be functionalized and synchronized to the pasteurization machinery.

While it may not be determinative of the present issue to consider whether or not Treasury Department rulings have been consistent in determining which functions and enterprises are predominantly commercial in nature because only an imperfect basis of comparison is thereby permitted, nevertheless, there are some activities which have a much higher commercial connotation than a dairy plant which have been held to be non-commercial (Appendix, page 54-55).

The District Court in attempting to view the problem from the standpoint of legislative intent quotes from remarks made by Senator Harrison as a member of the Senate Finance Committee in a discussion concerning a proposed revision in 1933 in which he said:

"I am telling the Senators nothing new when I remind them that we had a fight here in 1932 over the imposition of this tax. The Senate imposed a three per cent electric energy tax, and it was finally adopted, to be collected from the consumer of electric energy. We applied that only on domestic and commercial energy; *that is, electric energy used in stores and dwellings that are classified as commercial and domestic.* There

was no tax in the 1932 act imposed upon energy employed in industry." (R. 144) (Italics supplied) (77 Congressional Record, Part 3, p. 3212-3213)

Senator Reed also commented along the same general lines when he indicated that electrical energy sold for commercial use as well as domestic, "means that we shall get a revenue out of electricity *sold to shops and offices and places of that sort*" (75 Congressional Record, Part 10, page 11608).

From the remarks of both senators, it would seem that at least one objective of the proposed legislation was to exclude all productive and industrial consumption from being included as a taxable transaction without regard to whether or not manufacturing was technically involved. The intention seems to have been to use the term "commercial consumption" in its generally accepted meaning, namely, for uses which are clearly associated with the idea of trade, such as buying, selling and exchanging. "Stores" and "shops and offices and places of that sort" were specifically mentioned in the discussions. The only "store" of a dairy plant is the delivery wagon. In this respect, its plant is a place for the preparation of the product which later goes into the wagon. All operations conducted within the plant are necessary in the preparation of a finished product for market. The receiving and handling of milk can be compared to the receipt and handling of iron ore by the steel industry. The use of machinery in a pasteurization plant is a reality and a recognized chemical change takes place in the milk as the result of a physical and mechanical process. There is no basis in the statute, as indicated by its language or legislative history, to determine that a dairy plant is a commercial plant because the industry of which it is a part had its beginnings in the sale of milk in the same form as when received from the herd, nor because the present art

of pasteurization is employed for the rendition of a product for direct use by the consumer. The present industry is distinguishable only in degree, if at all, from the oil industry where crude oil is refined by a company to be placed directly in its own filling stations for sale to the motorist. It is true that the medium of transportation may intervene between these two steps, but where oil is transported long distances by pipe lines under the control of the same company, the parallel becomes more apparent.

CONCLUSION

The true nature of pasteurization has been amply developed upon a factual basis in the instant record. The facts are in accord with those which have been developed in other cases wherein the nature of the process has received judicial inquiry. The characterization of the industry as one devoted wholly to a commercial activity is based upon the premise that the product which is merchandized *resembles* milk in its natural state. Even if there was no change in the product except imparting pathogenic sterility thereto, accomplished through plant operations, the product sold could not be truly said to be the same as that acquired in its raw state. In addition, however, pasteurization effects a certain chemical change. Dairy plants are not engaged in such activities as were intended by Congress to be classified as commercial, but were in fact industrial processing plants whose functions were not calculated by Congress to be subjected to economic discrimination because of the chance circumstance of their either obtaining purchased power or power developed in their own plants.

Those functions which are carried on within a plant should be distinguished from activities pursued beyond the confines of such plant. The Regulations recognize the need for such a distinction. Unless such differentiation is pre-

served, the application of both the Regulations and the Act will be extended in an unauthorized manner to situations not originally within Congressional contemplation.

The petitioner is entitled to recover back the amount of tax paid by it on the sales of electrical energy to the dairy plants and respectfully requests a reversal of the judgment entered against it in the Circuit Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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Wisconsin Electric Power Company.

APPENDIX

Internal Revenue Code:

Sec. 3411. Tax on Electrical Energy for Domestic or Commercial Consumption.

(a) There shall be imposed upon electrical energy sold for domestic or commercial consumption and not for resale a tax equivalent to 3⅓ per centum of the price for which so sold, to be paid by the vendor under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe. The sale of electrical energy to an owner or lessee of a building, who purchases such electrical energy for resale to the tenants therein, shall for the purposes of this section be considered as a sale for consumption and not for resale; but the resale to the tenant shall not be considered a sale for consumption.

* * *

(26 U.S.C. 1940 ed., Sec. 3411) (26 U.S.C.A. 3411)

Section 3411 (a) was amended by the Revenue Act of 1941, c. 412, 55 Stat. 687, Sec. 521 (a) (19), to change the three per cent tax to three and one-third per cent but left the section otherwise the same.

Revenue Act of 1932, c. 209, 47 Stat. 169:

Sec. 616. Tax on Electrical Energy.

(a) There is hereby imposed a tax equivalent to 3 per centum of the amount paid on or after the fifteenth day after the date of the enactment of this Act, for electrical energy for domestic or commercial consumption furnished after such date and before July 1, 1934, to be paid by the person paying for such electrical energy and to be collected by the vendor.

* * *

Act of June 16, 1933, c. 96, 48 Stat. 254:

Sec. 6 (a) Effective September 1, 1933, section

616 of the Revenue Act of 1932 is amended to read as follows:

Sec. 616. Tax on Electrical Energy for Domestic or Commercial Consumption.

(a) There is hereby imposed upon electrical energy sold for domestic or commercial consumption and not for resale a tax equivalent to 3 per centum of the price for which so sold, to be paid by the vendor under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe. The sale of electrical energy to an owner or lessee of a building, who purchases such electrical energy for resale to the tenants therein, shall for the purposes of this section be considered as a sale for consumption and not for resale, but the resale to the tenant shall not be considered a sale for consumption.

* * *

Treasury Regulations 42, promulgated under the Revenue Act of 1932:

Art. 40. *Scope of tax.*—The tax applies to the amount paid for all electrical energy furnished for domestic or commercial consumption, either by a privately or publicly owned operating electrical power company.

"Electrical energy for domestic or commercial consumption" includes all electrical energy furnished the consumer except electrical energy furnished for industrial consumption. Electrical energy for industrial consumption includes that used generally for industrial purposes, that is, in manufacturing, processing, mining, refining, irrigation, shipbuilding, building construction, etc., and by public utilities, waterworks, telephone, telegraph, and radio companies, railroads, and other common carriers.

The tax attaches to all amounts paid for electrical energy for domestic or commercial consumption irrespective of whether any of the energy paid for is actually used. In other words, the tax is due on all payments for electrical energy whether in the form of a minimum charge, a flat charge, or otherwise.

T. D. 4393, XII-2 Cum. Bull. 322 (1933):

* * *

Section 616 of the Revenue Act of 1932 was amended by section 6 (a) of the Act of Congress approved June 16, 1933 (Public, No. 73, Seventy-third Congress). In conformity with the law as so amended, Chapter V of Regulations 42, approved October 22, 1932, is amended, effective with respect to electrical energy sold on or after September 1, 1933, to read as follows:

* * *

Art. 39. *Effective period.*—The tax applies to electrical energy sold on or after September 1, 1933, and before July 1, 1935.

Art. 40. *Scope of tax.*—The tax is imposed upon electrical energy sold for domestic or commercial consumption and not for resale, except as provided hereinafter.

The term "electrical energy sold for domestic or commercial consumption" does not include (1) electrical energy sold for industrial consumption, e.g., for use in manufacturing, processing, mining, refining, shipbuilding, building construction, irrigation, etc., or (2) that sold for other uses which likewise can not be classed as domestic or commercial, such as the electrical energy used by public utilities, waterworks, telegraph, telephone and radio communication companies, railroads, other common carriers, educational institutions not operated for profit, churches, and charitable institutions. However, electrical energy is subject to tax if sold for use in the commercial phases of industrial or other businesses, such as in office buildings, sale and display rooms, retail stores, etc.

Where electrical energy is sold to a single consumer for two or more purposes, through separate meters, the specific use for which the energy is sold through each meter, i.e., whether for domestic or commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy used at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of this tax.

Treasury Regulations 46 (1940 ed.):

Sec. 316.190 (as amended by T. D. 5099, 1941-2 Cum. Bull. 267). *Scope of tax.*—The tax imposed by section 3411 (a) of the Internal Revenue Code, as amended, applies, except as provided hereinafter, to all electrical energy sold for domestic or commercial consumption and not for resale.

The term "electrical energy sold for domestic or commercial consumption" does not include (1) electrical energy sold for industrial consumption, e.g., for use in manufacturing, mining, refining, shipbuilding, building construction, irrigation, etc., or (2) that sold for other uses which likewise can not be classed as domestic or commercial, such as the electrical energy used by electric and gas companies, waterworks, telegraph, telephone, and radio communication companies, railroads, other similar common carriers, educational institutions not operated for private profit, churches, and charitable institutions in their operations as such. However, electrical energy is subject to tax if sold for consumption in commercial phases of industrial or other businesses, such as in office buildings, sales and display rooms, retail stores, etc., or in domestic phases, such as in dormitories, or living quarters maintained by educational institutions, churches, charitable institutions, or others.

Where electrical energy is sold to a consumer for two or more purposes, through separate meters, the specific use for which the energy is sold through each meter, i.e., whether for domestic or commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy consumed at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of this tax.

* * *

ACTIVITIES WHICH HAVE BEEN RULED AS NON-COMMERCIAL IN NATURE AND HENCE NON-TAXABLE (Prentice-Hall, Federal Tax Service, 1948, Vol. 3, paragraph 38746).

Bottling works (S. T. 518, C. B. Dec. 1932, p. 498).

Cleaners and Dyers—except branch offices and agencies (informal ruling No. 45 by Bureau of Internal Revenue, August 10, 1932).

Closed Industrial Plants—Electric energy to an industrial plant for consumption during a period of time when its industrial activities have temporarily ceased for the purpose of maintaining or protecting the plant is not furnished for domestic or commercial consumption. (S. T. 641, C. B. June 1933, p. 410.)

Dairies engaged in the manufacture and sale of butter and cheese. (S. T. 637, C. B. June 1933, p. 409.)

Laundries (S. T. 463, C. B. Dec. 1932, p. 496).

Meat Packing company branches (S. T. 525, C. B. Dec. 1932, p. 499).

Grain elevators—Though commercial elevators are usually taxable, electrical energy consumed in a grain elevator for purposes of cleaning, drying, grinding and bleaching grain is considered industrial consumption and is not subject to tax. (S. T. 527, C. B. Dec. 1932, p. 499; G. C. M. 13315, C. B. Dec. 1934, p. 405)

Newspapers—printing of. Informal ruling by Bureau of Internal Revenue, July 29, 1932.

Printing—non-taxable. Informal ruling No. 45 by Bureau of Internal Revenue, Aug. 10, 1932.